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CENTRAL DISTRICT OF CALIFORNIA
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UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION

In re HOMESTORE.COM, INC. SECURITIES LITIGATION

This Document Relates To:

ALL ACTIONS.

Master File No. 01-CV-11115 MJP

CLASS ACTION

FIRST AMENDED CONSOLIDATED COMPLAINT FOR VIOLATION OF FEDERAL SECURITIES LAWS

DEMAND FOR JURY TRIAL

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I. INTRODUCTION

1. This case represents the very worst of the Internet "bubble." The false revenue scheme at Homestore.com ("Homestore") could not have happened without the knowledge of and active participation of senior management and directors in the company and willing outside participants. The Homestore financial fraud was based on a simple concept: since the company was not able to meet the expectations of Wall Street through the production of legitimate revenues, Homestore resorted to "buying revenues." In order to do so, Homestore falsified its balance sheet, a process which broke accounting and financial reporting rules. The incentive of Homestore executives to participate in this fraud was also simple: the greed of cashing in on the Internet "bubble" through stock options and insider trading.

2. The top two executives at the company, the founder of Homestore, Stuart H. Wolff, and his first employee, Peter B. Tafeen, created a corporate culture premised on the necessity of Homestore "beating" the revenue numbers put up by other high-flying technology companies, and never disappointing the analysts. This fraud was so pervasive that the deals done to meet these goals were known as "Peter Deals" after Tafeen, and the absolute requirement to meet Homestore's projected revenue targets was known as the "bogie" or the "plug." The company became obsessed with hitting the "bogie" at all costs, even to the point of falsifying transactions as alleged in this complaint. These fraudulent transactions resulted in restating Homestore's reported financial statements in the amount of <u>$192,598,000</u> for the years 2000 and 2001.

3. Homestore could not undertake this financial fraud without the active and knowing participation of the Defendants and others named herein. Homestore was a company built on *alliances* with the biggest names in the real estate and Internet industries. Two of the most important pillars for Homestore's rapid ascendancy into the highest ranks of Wall Street's Internet darling companies were

AOL/Time Warner and Cendant Corporation. Both of these giants had a huge financial stake in Homestore, and in the case of Cendant, two seats on the Board of Directors.

4. Within the corporate ranks of AOL and Cendant, top executives were motivated to make their own departments' bottom line look good. These executives worked deals with Tafeen and they developed a relationship in which AOL and Cendant would help Homestore make the "bogie" when Homestore was short. The principal participants in this financial scheme at AOL were David Colburn and Eric Keller. Colburn was the AOL Executive Vice President in charge of structuring many of AOL's advertising and commerce deals. On August 8, 2002, Colburn was fired and the locks to his office were changed. Keller reported to Colburn and he was described as the number two deal maker at AOL. Keller was placed on leave in August 2001 and later dismissed from AOL. The principal participant in this financial scheme at Cendant was Richard A. Smith, who not was not only Chairman and Chief Executive Officer of the Real Estate Division for Cendant, but was also on Homestore's Board. AOL and Cendant were also motivated by financial considerations, driven by cashing in on their investment in Homestore, and not allowing Homestore to disappoint Wall Street so that the stock price would stay as high as possible. As alleged herein, these were Homestore's biggest partners in the financial fraud, but there were many others.

5. The Homestore financial fraud could not be implemented without the knowing participation of the company's auditor: PricewaterhouseCoopers ("PWC"). Homestore's main contact at PWC was Richard Withey, who had long established relationships with the senior financial managers at Homestore, four of whom, John M. Giesecke (former CFO and the COO), Joseph J. Shew (former VP of Finance and the CFO), John D. DeSimone (the Director of Operations) and Jeff Kalina (a Director of Transactions), were PWC alumni who worked with Withey.

PWC provided the roadmap for the financial fraud, and lent its considerable reputation and credibility to the Homestore financial statements which PWC audited. Those financial statements were materially misstated for the years 2000 and 2001, as a direct result of false revenues which PWC helped Homestore recognize.

6. This action is brought by the California Teachers' Retirement System ("CalSTRS"), the Court appointed Lead Plaintiff in this securities class action. CalSTRS' participant members include several hundred thousand teachers throughout California whose retirement funds are administered and invested by CalSTRS.

7. Substantial portions of this complaint, including the descriptions of the specific transactions at the heart of the fraud, are based on information obtained from confidential sources with personal knowledge of how the fraud was accomplished and the nature of Defendants participation therein. In addition, three of the top executives in the Finance Department of Homestore, <u>Giesecke</u>, <u>Shew</u> and <u>DeSimone</u>, have <u>pled guilty</u> to federal charges of securities fraud. The Information succinctly describes how the criminal conspiracy was accomplished:

> **"In order to achieve and attempt to achieve the goals of the scheme, defendants GIESECKE and SHEW, high-ranking corporate officers at Homestore, and others, caused Homestore to engage in a complicated series of "round-trip" transactions whereby Homestore entered into agreements with various intermediaries to facilitate the circular flow of money from Homestore to the various intermediaries and then back to Homestore. These "round-trip" transactions and the accompanying circular flow of money enabled Homestore to recognize its own cash as revenue in violation of GAAP. These illegal arrangements allowed Homestore to fraudulently inflate its revenue by essentially buying that revenue in violation of GAAP."**

<u>See</u>, Exhibit A.

II. <u>JURISDICTION AND VENUE</u>

8. Federal subject matter jurisdiction exists pursuant to 28 U.S.C. §§ 1331 and 1337 and §27 of the Exchange Act, 15 U.S.C. §78a(a), and §22 of the Securities Act 15 U.S.C. §77(v). The claims asserted herein arise under and

pursuant to §§10(b) and 20(a) of the Securities and Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §78j(b) and 78t(a), and Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated thereunder by the Securities and Exchange Commission ("SEC").

9. Venue is appropriate in the Central District of California pursuant to §27 of the Exchange Act and 28 U.S.C. §1391(b). Homestore has its principal place of business in Westlake Village, California and many of the acts alleged herein, including preparation and dissemination of the misleading statements to the investing public, occurred in substantial part in this District.

10. The Defendants, directly and/or indirectly, used the means and instrumentalities of interstate commerce, the United States mails, and the facilities of the national securities markets in connection with the acts, conduct, and other wrongs complained of herein.

III. THE PARTIES

A. PLAINTIFF

11. Plaintiff, the **California State Teachers' Retirement System** ("CalSTRS"), is the third largest public pension fund in the United States. CalSTRS administers retirement, disability and survivor benefits for California's public school educators in grades kindergarten through community college. CalSTRS serves approximately 686,855 members and benefit recipients. CalSTRS is administered by a 12-member Retirement Board and employs 540 employees. CalSTRS purchased 431,123 total shares of Homestore common stock from May 4, 2000 to December 21, 2001, and invested a total of $13,361,336.03. CalSTRS suffered out of pocket losses on its investments in Homestore common stock of over $9 million.

12. On March 25, 2002, the Court appointed CalSTRS as Lead Plaintiff.

13. CalSTRS and members of the Class purchased Homestore stock in the open market, unaware that Defendants' statements and omissions regarding the

stock and financial results were false and/or misleading and were causing Homestore's stock price to be artificially inflated. Plaintiff and the Class relied upon Defendants' statements and omissions in Homestore's public reports, press releases, and SEC filings when they purchased Homestore common stock and were thus injured by the Defendants actions. Plaintiff and the Class further relied on the integrity of the market for Homestore securities and the fact that Homestore common stock was fairly priced. Believing the Defendants' statements to be true has resulted in injury to the Plaintiff and each Class member.

B. DEFENDANTS

1. Corporate Defendants

i. Homestore.com, Inc.

14. Defendant Homestore was the largest Internet-based provider of residential real estate listings and related content in the world. Homestore maintains its principal place of business in Westlake Village, California. Homestore's common stock was traded on the NASDAQ, a national and efficient market, under the symbol (HOMS) until trading was halted on December 21, 2001, and then again, beginning January 7, 2002. On February 22, 2002, Homestore's ticker symbol was appended to trade under the symbol (HOMSE). Homestore's web site provides listings of existing and newly constructed homes that are available for sale, as well as apartments and other rental opportunities. The web site also provides information regarding financing and insurance, moving, home improvement, and decorating, and offers an on-line shop where visitors can purchase amenities for their home and garden, including appliances and electronics.

ii. AOL Time Warner, Inc.

15. Defendant AOL Time Warner, Inc. ("AOL") is the largest Internet-powered media and communications company in the world formed in January 2001 through the merger of America Online, Inc. ("America Online") and Time

Warner Inc. ("Time Warner"). AOL's business includes the premier Internet company, America Online, with 34 million subscribers, cable television networks, television production and publishing. AOL's stock is currently traded on the New York Stock Exchange under the symbol AOL.

iii. <u>Cendant Corporation</u>

16. Defendant Cendant Corporation ("Cendant") is a massive conglomerate with holdings in real estate, travel and vehicle rentals. Its Fiscal Year 2000 profits were $1.5 billion based upon $3.9 billion in revenues. According to its web site: "Cendant's Real Estate Division is the leader in the world's largest industry, with affiliates responsible for more than one out of every four homes sold or purchased in the U.S." Cendant also runs one of the country's largest retail mortgage originators, the leading relocation services company, and franchises a leading commercial real estate brokerage system. Its real estate franchises include: CENTURY 21, Coldwell Banker, Coldwell Banker Commercial, and ERA. Its hospitality segment caters to the mid-economy market and Cendant operates such hotels as the Days Inn, Ramada and Howard Johnson. One of its vehicle franchises is Avis. In August of 2002, Cendant announced that it would acquire Budget Group, Inc. Cendant's common stock is traded on the New York Stock Exchange, under the symbol CD.

iv. <u>L90 a/k/a Max Worldwide</u>

17. L90 was a Los Angeles-based media company that provided direct and on-line marketing services. L90's offline direct marketing business, formerly known as Novus List Management, was established in 1989 and focused on list management, alternative media, and data services. L90 established its on-line advertising and direct marketing businesses in 1997. L90 used adMonitor technology to help companies build brand recognition, acquire new customers, and increase sales. L90 acquired DoubleClick, a North American media business, for $9.5 million, merging the two companies into MaxWorldwide. MaxWorldwide

creates traditional and interactive on-line advertising campaigns using strategies such as co-branding, content integration, sweepstakes, and virtual and email marketing. MaxWorldwide stock is currently traded on the NASDAQ national stock exchange under the symbol MAXW.

18. On March 21, 2002, a class action lawsuit was filed on behalf of purchasers of L90 common stock, alleging that, during the period between July 26, 2001 and March 12, 2002, L90 violated federal securities laws by accounting for revenue in a manner contrary to generally accepted accounting principals.

19. In March 2002, L90 revealed that federal investigators were questioning it concerning past reporting of revenues, specifically with regard to transactions with Homestore. The SEC has subpoenaed records and determined that at least one member of L90's Board of Directors was tied to two barter advertising transactions that occurred with Homestore in the second and third quarters of 2001. The SEC is investigating allegations of wire transfers, purportedly for advertising services, between L90, Homestore and Hi-Speed Media, that effectuated barter transactions, to determine if they were improperly accounted for as revenue. In a May 16, 2002 Wall Street Journal Online front-page article entitled, "SEC Broadens Its Investigation into Revenue-Boosting Tricks," the Journal reported that "SEC officials are investigating L90 Inc., Homestore and Hi-Speed Media for wire transfers that moved money among the three companies, in transactions that became increasingly complex and made a paper trail hard to follow."

20. L90 issued a May 6, 2002 press release which stated that it was conducting an internal investigation into "groups of transactions in 2000 and 2001 involving multiple vendors and service providers . . . (that) appear to represent barter transactions. The results will be restated because these transactions do not appear to meet the criteria for revenue recognition under generally accepted accounting principles." In conjunction with its internal investigation, L90 reduced

its 2000 and 2001 revenue by $8.3 million (10%), reclassifying $250,000 of revenue as "other income."

v. Dorado Corporation

21. Defendant Dorado Corporation ("Dorado"), a California corporation with its principal place of business in California, provides e-commerce solutions by making it possible for financial services companies to quickly and cost-effectively conduct complex transactions on-line in a secure environment.

vi. Akonix Systems, Inc.

22. Defendant Akonix Systems, Inc. (Akonix") is a security software company which develops products to protect corporate networks against threats arising from public instant messaging and peer-to-peer file sharing. In addition to developing security software, Akonix developed Akonix Enterprise Platform, a product that enables organizations to build individual networks that facilitate online interaction between customers. Akonix was formed in July of 2000 and is a privately held California corporation based in San Diego, California. Akonix is a venture funded corporation. Homestore struck a deal with Akonix to use its Enterpirse Platform software.

vii. Internet Pictures Corporation

23. Defendant Internet Pictures Corporation ("Internet Pictures") provides imaging solutions to facilitate commerce, communication, security and entertainment. Internet Pictures creates, processes and manages a variety of media including still images, 360-degree by 360-degree immersive images, video, animation, text and audio. Internet Pictures has one of its headquarters in California. Internet Pictures' stock is currently traded on the NASDAQ national stock exchange under the symbol IPIX.

viii. CityRealty.com, Inc.

24. Defendant CityRealty.com, Inc. ("CityRealty"), an affiliate of Real Estate On-Line, LLC, provides on-line real estate services to commercial real

estate organizations. Through its website exchange, brokers can search for, and contact, all buyers or renters interested in purchasing/renting their property.

ix. <u>Classmates Online, Inc.</u>

25. Defendant Classmates Online, Inc. ("Classmates") is a networking service connecting classmates, military personnel, friends, teachers and others online. Founded in 1995, Classmates serves 31 million members, making the site the second largest member community on the Internet. It adds 80,000 to 100,000 members per day. Classmates is consistently ranked one of the top 15 most highly trafficked properties on the Internet by Nielsen/Net Ratings, and has over 1.7 million paid subscribers.

x. <u>CornerHardware.com</u>

26. Defendant CornerHardware.com ("CornerHardware) provides on-line hardware retail and related customer services for home products. Beginning in 2000, Defendant Homestore provided website advertising to CornerHardware and also purchased its stock with cash.

xi. <u>GlobeXplorer, Inc.</u>

27. Defendant GlobeXplorer, Inc. ("GlobeXplorer"), a leading technology company headquartered in California, provides high-speed access to satellite images and interactive aerial photos over the Internet and to wireless devices.

xii. <u>Privista, Inc.</u>

28. Defendant Privista, Inc. ("Privista") is a credit monitoring and management company with access to over 200 million consumer credit files, providing consumers protection and management for their credit information. Privista provides businesses with private-labeled services to enhance revenue and branding, and technology services to acquire customers.

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xiii. <u>PromiseMark, Inc.</u>

29. Defendant PromiseMark, Inc. ("PromiseMark"), founded in 1997, provides Internet and data related protection plans. PromiseMark, Inc. sells its suite of Internet service plans via channel partners utilizing co-branded web sites and in the retail marketplace.

xiv. <u>RevBox, Inc.</u>

30. Defendant RevBox, Inc. ("RevBox") provides post-purchase online support for both e-commerce merchants and consumers in the form of extended service contracts, fixed-rate repair services, personal purchase tracking tools and an authorized repair shop locator. RevBox maintains its principal place of business in California.

xv. <u>SmartHome, Inc.</u>

31. Defendant SmartHome, Inc. ("SmartHome") is a retailer and leading manufacturer of home automation electronics, selling over 4,000 products through catalogs and over the Internet.

xvi. <u>WizShop.com, Inc. (acquired by Semotus)</u>

32. Defendant WizShop.com, Inc. ("WizShop"), is a California based company, and a wholly owned subsidiary of Defendant Semotus Solutions, Inc. ("Semotus") another California company. WizShop builds and maintains outsourced e-commerce environments for the world's largest Internet properties. WizShop also creates online sales and merchandising programs for its clients. Semotus' stock is currently traded on the AMEX national stock exchange under the symbol DLK.

xvii. <u>Top Producer Systems, Inc.</u>

33. Defendant Top Producer Systems, Inc. ("Top Producer") was founded in 1982, provides sales and marketing software for real estate professionals.

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2. Individual Defendants

34. The Individual Homestore Defendants listed in the paragraphs below (collectively "Individual Homestore Defendants") served as senior officers, directors and/or employees of Homestore during the Class Period. The Individual Homestore Defendants, because of the positions that they held at Homestore, were able to control the contents of the representations made to stockholders and the public, had access to adverse undisclosed information regarding the company which contradicted the information disseminated to the public, and had the authority to prevent or correct the disseminations. Furthermore, the Individual Homestore Defendants each had an affirmative duty to promptly disseminate accurate and truthful information and/or correct any misleading and untrue information regarding Homestore's financial condition, performance, growth, operations, financial statements, business, products, markets, management, earnings, and business prospects. Despite this affirmative duty, the Individual Homestore Defendants knowingly and intentionally made misleading statements and omissions in order to artificially inflate the price of Homestore stock so that they could sell their personal shares at prices far exceeding market value.

35. The Individual Homestore Defendants knowingly and intentionally participated in a scheme to defraud the investing public and members of the Class by entering into illegal transactions with Homestore.

36. The Individual Defendants, namely David Colburn, Eric Keller and Richard Smith, knowingly participated in Homestore's scheme to defraud the investing public and members of the Class. Moreover, the Individual Defendants actively participated Homestore's improper conduct during the course of and in furtherance of the conspiracy to recognize false revenues for Homestore, and conceal such information from the public.

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i. Stuart H. Wolff

37. Individual Homestore Defendant Stuart H. Wolff ("Wolff") joined Homestore in November 1996 as Chairman and Chief Executive Officer, a position he continuously held until he was reassigned as an employee and Director in January 2002. In August 1998, Wolff exercised options to acquire shares of Homestore's common stock in exchange for a Promissory Note. In April 1999, Wolff again exercised options to acquire shares of Homestore's common stock in exchange for Promissory Notes due to Homestore. For the year 2000, Wolff was paid $487,115 in salary and bonuses and was given 400,000 stock options. For the year 2001, Wolff was paid $240,097 in salary and was given 900,000 stock options. During the Class Period, Wolff sold 693,600 of his shares for a total of $33,763,389.75 in insider trading proceeds. Additionally, Wolff signed every financial statement issued by Homestore during the Class Period, including every Form 10-Q and 10-K financial statement of Homestore for the year 2000 and all Form 10-Qs for the first three quarters of 2001.

ii. Peter B. Tafeen

38. Individual Homestore Defendant Peter B. Tafeen ("Tafeen") was the Executive Vice President of Business Development and Sales at Homestore. He joined Homestore in September 1997 as Executive Vice President of Business Development with a salary of $140,000 plus bonuses and stock options, and was promoted to his current position in February 2001. For the year 2000, Tafeen was paid $274,858 in salary and bonuses and was given 100,000 stock options. During the Class Period, Tafeen sold 489,195 of his shares for a total of $18,095,160.45 in insider trading proceeds.

iii. David M. Rosenblatt

39. Individual Homestore Defendant David M. Rosenblatt ("Rosenblatt") was the Senior Vice President and General Counsel for Homestore from October 1998 until he resigned in January 2002. For the year 2000, Rosenblatt was paid

$242,731 in salary and bonuses. For the year 2001, Rosenblatt was paid $447,346 in salary and bonuses. During the Class Period Rosenblatt sold 255,100 of his shares for a total of $9,738,160.50 in insider trading proceeds. As General Counsel**,** Rosenblatt played a key role in drafting and/or approving Homestore's public filings and was instrumental in developing and implementing the revenue deals which are the subject of this complaint.

iv. Catherine Kwong Giffen

40. Individual Homestore Defendant Catherine Kwong Giffen ("Giffen") was the Senior Vice President of Human Resources at Homestore. She joined Homestore in April of 1998 as the Vice President of Administration and in her first year, her employment contract provided that she would earn a base salary $120,000 with a discretionary 25% bonus and stock options. During the Class Period, Giffen sold 209,183 shares for a total of $8,176,779.64 in insider trading proceeds.

v. Allan P. Merrill

41. Individual Homestore Defendant Allan P. Merrill ("Merrill") is the Executive Vice President of Corporate Development at Homestore. He was appointed president of Homebuilder.com in April 2000 and promoted to Executive Vice President of the Corporate Development Group in October 2001. His 2002 employment contract provided that he would earn $325,000 in base salary with stock options. Merrill joined Homestore after 13 years with the investment banking firm Warburg Dillon Read.

vi. Sophia Losh

42. Individual Homestore Defendant Sophia Losh ("Losh") was Senior Vice President of the Strategic Alliance Group ("SAG") of Homestore. Losh worked directly under Tafeen until the second or third quarters of 2001. Losh's primary responsibility was to record advertising revenues and she focused on large finance clients.

vii. <u>Jeff Kalina</u>

43. Individual Homestore Defendant Jeff Kalina ("Kalina") was a Director of Transactions for Homestore. Kalina worked in the Business Development Department of Homestore with Tafeen. Kalina personally participated in the improper revenue recognition deals that are the subject of this First Amended Complaint.

viii. <u>David Colburn</u>

44. Individual David Colburn ("Colburn") was Executive Vice President and President of Business Affairs and Development for AOL and its chief dealmaker. Colburn was in charge of structuring many of AOL's advertising and commerce deals. Prior to his position as Executive Vice President, Colburn was a lawyer and Senior Vice President of Business Affairs for AOL. After Defendant Eric Keller left AOL, Colburn continued to participate in the triangular fraudulent scheme. According to *a Online Reporter* September 30, 2002 article, Colburn was locked out of his office and terminated in August 2002 after AOL announced that the Department of Justice and SEC had begun investigations into the AOL/Homestore/PurchasePro deal. Colburn has now retained counsel to represent him in connection with the SEC's and U.S. Attorney's investigations into the relationship between Homestore, AOL and PurchasePro.

ix. <u>Eric Keller</u>

45. Individual Defendant Eric Keller ("Keller") was Senior Vice President under Colburn at AOL. In or about February and March of 2001, Keller and Defendant Tafeen concocted a triangular scheme whereby Homestore would purchase goods or services from certain third party companies, AOL would pay Homestore cash for advertising, and these third party companies (using money round tripped by Homestore) would purchase advertising from AOL. According to press reports, AOL put Eric Keller on leave and then fired him in August of 2001 as a result of the fraudulent deals which he made on AOL's behalf with

Homestore and PurchasePro. According to a September 27, 2002 *Toronto Star* article, Keller is being investigated by the SEC for his role in the Homestore/AOL/PurchasePro fraudulent transactions.

x. Richard A. Smith

46. Individual Defendant Richard A. Smith ("Smith") has been Chairman and Chief Executive Officer of the Real Estate Division for Cendant since December 1997. Smith was President of the Real Estate Division for Cendant (then known as HFS Inc.) from October 1996 to December 1997 and Executive Vice President of Operations for HFS from February 1992 to October 1996. Smith is a Director of NRT Incorporated. In 2001, as part of Cendant acquiring a large stake in Homestore, Smith became a voting member of Homestore's Board of Directors.

3. Accountant Defendant

i. PricewaterhouseCoopers LLP

47. Defendant PricewaterhouseCoopers LLP ("PWC") is a multinational auditing, accounting and consulting firm. It is a limited liability partnership, with principal headquarters in the state of New York, and has multiple offices in California, including an office in Century City, California which conducted the Homestore audit. PWC became the auditors for Homestore on January 21, 1999, before Homestore's August 5, 1999 initial public offering ("IPO"), and participated in the due diligence for that offering. PWC provided both auditing and consulting services to Homestore, and issued unqualified audit opinions on Homestore's financial statements, including Homestore's 2000 Form 10-K. In addition, PWC, as part of its audit procedures, analyzed the quarterly results contained in Homestore's Form 10-Qs, including those quarters that were restated as a result of the wrongful conduct alleged herein.

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C. UNNAMED PARTICIPANTS

48. Numerous individuals and entities participated actively during the course of and in furtherance of the conspiracy to recognize false revenues for Homestore, and conceal such information from the public. The admitted facts by persons involved in the scheme demonstrate that there was a conspiracy and that many acts were done in the course of and in furtherance of the conspiracy by statements, conduct, and intent to defraud. The individuals and entities acted in concert by forming joint ventures and by acting as agents for principals, in order to advance the objectives of the conspiracy to increase false revenues for each of the participants. The acts were intended to promote the conspiratorial objectives and the conspiracy will be shown by a preponderance of the evidence. U.S. v. Peralta, 941 F.2d 1003 (9th Cir. 1991).

49. Among those who are unnamed participants in the wrongful conduct, as alleged below, with full knowledge of their acts were:

1. Joseph J. Shew

50. Joseph J. Shew ("Shew") is a Certified Public Accountant who joined Homestore in August 1998 as Controller. He was promoted to Vice President of Finance in January of 1999, and was made Senior Vice President, Chief Financial Officer and Assistant Secretary in December 2001. On December 6, 2001, Homestore announced that Shew had resigned for "personal reasons" and that it had "initiated a search for a new Chief Financial Officer." Prior to his time at Homestore, Shew spent six years as a certified public accountant with Price Waterhouse LLP, most recently as Manager.

51. During his entire tenure at Homestore, Shew participated in acts during the course of and in furtherance of the conspiracy to defraud the shareholders, the company, the SEC and the public of true information about the financial condition of Homestore.

52. Shew, along with others, as set forth in the complaint:

i. Knowingly and unlawfully, combined, conspired and agreed to employ devices, schemes and artifice to defraud the public in connection with the purchase and sale of Homestore securities using means in violation of the law.

ii. Made untrue, false and misleading statements of material fact in violation of the law.

iii. Knowingly falsified the books and records of Homestore in violation of the law.

iv. Along with others, engaged in insider trading of his stock.

53. Shew acted in a manner to achieve the goals of the scheme to defraud by causing Homestore to engage in a series of transactions, as set forth in detail in the complaint which were, in part, sham transactions designed to facilitate the circular flow of money through Homestore and other entities to recognize false revenues, when in fact little or no real revenues could be recognized.

54. These transactions were simply the transfer of money variously called "round trips," "circular transactions," "back-and-forth transactions," "barter transactions," each of which were intended to falsely boost revenues at Homestore.

55. The purpose of these activities was to artificially increase the quarterly revenues and to overstate the true financial picture of Homestore in order to reach the goals set for the quarters. Shew had, and has actual knowledge, through meetings, conversations with co-conspirators, telephone exchanges, and e-mails with high-ranking executives, that Homestore was improperly and fraudulently recognizing revenues through the above activities.

56. Following the fraudulent activities in the financial periods, Shew and others participated in disseminating false financial information via press releases, public statements, and various written material internally and externally to the public and investment analysts.

57. All of the above and more is set forth in the attached Information filed in September of 2002 by the United States and the U.S. Department of Justice in the U.S. District Court for the Central District to California, referenced herein above as Exhibit A.

58. On or about September 18, 2002, Shew entered into a plea agreement with the United States of America in which he pled guilty to Count One of the Information (Title 18, USC §371) and acknowledged that he entered into a conspiracy knowing of at least one of the objects of the conspiracy as set forth in the Plea Agreement, attached hereto as Exhibit B.

2. <u>John M. Giesecke, Jr.</u>

59. John M. Giesecke, Jr. ("Giesecke") is a Certified Public Accountant and served as the Chief Financial Officer from December of 1998 through December of 2000. In December of 2000, Giesecke became the Chief Operation Officer (COO) and in September of 2001, Giesecke became the President of Homestore's Retail and Consumer Services Division. He resigned in January 2002. During his entire tenure at Homestore, Giesecke participated in acts during the course of and in furtherance of the conspiracy to defraud the shareholders, the company, the SEC, and the public from the true information about the financial condition of Homestore.

60. Giesecke, along with others, as set forth in the complaint:

i. Knowingly and unlawfully, combined, conspired and agreed to employ devices, schemes and artifice to defraud the public in connection with the purchase and sale of Homestore securities using means in violation of the law.

ii. Made untrue, false and misleading statements of material fact in violation of the law.

iii. Knowingly falsified the books and records of Homestore in violation of the law.

iv. Along with others, engaged in insider trading of his stock.

61. Giesecke acted in a manner to achieve the goals of the scheme to defraud by causing Homestore to engage in a series of transactions, as set forth in detail in the complaint which were, in part, sham transactions designed to facilitate the circular flow of money through Homestore and other entities to recognize false revenues, when in fact little or no real revenues could be recognized.

62. These transactions were simply the transfer of money variously called "round trips," "circular transactions," "back-and-forth transactions," "barter transactions," each of which were intended to Homestore.

63. The purpose of these activities was to artificially increase the quarterly revenues and to overstate the true financial picture of Homestore in order to reach the goals set for the quarters. Giesecke had, and has actual knowledge, through meetings, conversations with co-conspirators, telephone exchanges, and e-mails with high-ranking executives, that Homestore was improperly and fraudulently recognizing revenues through the above activities.

64. Following the fraudulent activities in the financial periods, Giesecke and others participated in disseminating false financial information via press releases, public statements, and various written material internally and externally to the public and investment analysts.

65. All of the above and more is set forth in the attached Information filed in September of 2002 by the United States and the U.S. Department of Justice in the U.S. District Court for the Central District to California, referenced herein above as Exhibit A.

66. On or about September 18, 2002, Giesecke entered into a plea agreement with the United States of America in which he pled guilty to Count One of the Information (Title 18, USC §371) and acknowledged that he entered into a conspiracy knowing of at least one of the objects of the conspiracy as set forth in the Plea Agreement, which is attached hereto as Exhibit C.

3. John D. DeSimone

67. John D. DeSimone ("DeSimone") worked as Director of Operations, Planning and Transactions in the Finance Department from 1999 through June 2001. From June 2001 through October 2001, he served as Vice President of Transactions and was fully familiar with the daily transactions of Homestore. During his entire tenure at Homestore, DeSimone participated in acts during the course of and in furtherance of the conspiracy to defraud the shareholders, the company, the SEC and the public from the true information about the financial condition of Homestore.

68. DeSimone, along with others, as set forth in the complaint:

i. Knowingly and unlawfully, combined, conspired and agreed to employ devices, schemes and artifice to defraud the public in connection with the purchase and sale of Homestore securities using means in violation of the law.

ii. Made untrue, false and misleading statements of material fact in violation of the law.

iii. Knowingly falsified the books and records of Homestore in violation of the law.

iv. Along with others, engaged in insider trading of his stock.

69. DeSimone acted in a manner to achieve the goals of the scheme to defraud by causing Homestore to engage in a series of transactions, as set forth in detail in the complaint which were, in part, sham transactions designed to facilitate the circular flow of money through Homestore and other entities to recognize false revenues, when in fact little or no real revenues could be recognized.

70. These transactions were simply the transfer of money variously called "round trips," "circular transactions," "back-and-forth transactions," "barter transactions," each of which were included to falsely boost revenues at Homestore except to falsely boost revenues.

71. The purpose of these activities was to artificially increase the quarterly revenues and to overstate the true financial picture of Homestore in order to reach the goals set for the quarters. DeSimone had, and has actual knowledge of these transactions through meetings, conversations with co-conspirators, telephone exchanges, and e-mails with high-ranking executives that Homestore was improperly and fraudulently recognizing revenues through the above activities.

72. Following the fraudulent activities in the financial periods, DeSimone and others participated in disseminating false financial information via press releases, public statements, and various written material internally and externally to the public and investment analysts.

73. All of the above and more is set forth in the Information filed in September of 2002 by the United States and the U.S. Department of Justice in the U.S. District Court for the Central District to California, referenced herein above as Exhibit A.

74. On or about September 18, 2002, DeSimone entered into a plea agreement with the United States in which he pled guilty to Count One of the Information (Title 18, USC §371) and acknowledged that he entered into a conspiracy knowing of at least one of the objects of the conspiracy as set forth in the Plea Agreement which is attached hereto as Exhibit D.

4. Budget Group, Inc. /Ryder

75. Budget Group, Inc. ("Budget") is one of the largest vehicle rental companies in the world with revenues of $2.4 billion in 2000. Budget operates at more than 3,200 locations in over 120 countries and territories. There are nearly 1,000 corporate-owned and franchised locations in the United States alone. Budget's stock is currently traded over the counter under the symbol BDGPA.PK. Beginning in or about March of 2000, Budget and Homestore began entering into fraudulent round tripping transactions in which each purchased advertising from

one another. Homestore paid for its advertising through the issuance of 1,085,000 shares of common stock. In July of 2002, Budget declared bankruptcy. In August of 2002, Defendant Cendant announced that it was acquiring Budget.

5. Homestyles

76. HomeStyles Publishing and Marketing, Inc. ("HomeStyles") provided a source of pre-drawn home plans for builders and consumers, as well as services related to the homebuilding and home improvement market. In 2001, Homestore acquired HomeStyles and integrated HomeStyles products and services into Homestore's network of web sites.

6. MH2 Technologies as successor to BuildNet, Inc.

77. MH2 ("MH2") Technologies is the successor in interest to BuildNet, Inc. ("BuildNet"). MH2 is the leading provider of Internet-based job management tools for home builders. BuildNet is a business-to-business e-commerce services firm, providing management software to homebuilders and suppliers in the residential construction industry. BuildNet's aggregated software customer base includes homebuilders who accounted for approximately 43% of 1999 U.S. single-family home closings. Beginning in or about 2001, Homestore purchased Homestyles, a BuildNet subsidiary.

7. Bank of America, Inc.

78. Bank of America Corp. ("Bank of America") is a bank holding company with revenues in 2001 of $35 billion and earnings of $521 million. Through its subsidiaries, it provides financial products and services to individuals and businesses in 150 countries, including 4.3 million Internet users and through 4,200 banking centers in the United States.

IV. CLASS ACTION ALLEGATIONS

79. Pursuant to Rule 23(a) and (b)(3) of the Federal Rules of Civil Procedure, Plaintiff brings this lawsuit on behalf of itself and a class of persons and entities (the "Class") who purchased Homestore stock from January 1, 2000

through December 21, 2001 (the "Class Period"), inclusive. Excluded from the Class are Homestore and its subsidiaries, successors, predecessors, present and former officers and directors, and the Defendants and members of their immediate families, any person, firm, trust, corporation, officer, director or other individual or entity in which any Defendant has a controlling interest or which is affiliated with any of the Defendants, and any legal representatives, agents, affiliates, heirs, successors-in-interest or assigns of any excluded party.

80. This action is properly maintainable as a class action because it meets Rule 23 requirements for numerosity, commonality, typicality, and superiority.

81. The Class is numerous and spread throughout the United States, making the joinder of all Class members impracticable. Homestore had 117,463,297 shares outstanding as of November 1, 2001. Though the exact number of affected shareholders is unknown to Plaintiff and the Class at this time, there are thousands of potential class members, further indicating the impracticability of joinder in this action. The information as to the identity of the Class members can be readily determined from records maintained by Defendants and their agents.

82. The following are questions of law and fact, common to the class, which predominate over questions affecting individual members:

(a) Whether Defendants' acts as alleged herein violated federal securities laws;

(b) Whether Defendants engaged in the common course of conduct complained of herein;

(c) Whether disseminated documents, SEC filings, press releases and other statements, to the investing public and Homestore stockholders during the Class Period, misrepresented material facts about Homestore's operations, financial condition, and earnings;

(d) Whether Defendants' misrepresentations and failure to correct those misrepresentations complained of herein caused Homestore stock to be artificially inflated during the Class Period;

(e) The extent to which the members of the Class have sustained damages and the proper measure of those damages.

83. Plaintiff's claims are typical of those asserted by the other Class members and Plaintiff's interests are not adverse or antagonistic to the interests of the Class. Both the Plaintiff and Class members will claim that Defendants violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, as well as Section 20(a) of the Exchange Act.

84. Plaintiff will vigorously prosecute this action, and has retained competent counsel previously approved by this Court as lead counsel. Hence, Plaintiff is an adequate representative for the Class and will represent their interests fairly and adequately. Plaintiff does not anticipate any problem with managing this litigation as a class action.

85. The class mechanism is an efficient and fair method for adjudicating this action and is superior to other methods. The size of the Class would make other methods impracticable and without use of the class mechanism, many individual Class members might not be able to afford to prosecute their individual claims.

V. DEFENDANTS' WRONGFUL CONDUCT

A. Basis for Plaintiff's Allegations

86. Plaintiff's allegations contained in this section are based upon Plaintiff's ongoing investigation into the circumstances of this case. Plaintiff's have conducted many hours of interviews and consulted publically available documents. In order to protect certain sources of information, these sources have requested that their names remain confidential. Accordingly, rather than naming the sources of information, Plaintiff refers to the sources as "confidential sources" throughout this section of the complaint.

87. Information alleged to have come from Plaintiff's confidential sources are attributed to persons with personal knowledge of the events contained in this complaint. The confidential sources are persons who were employed by Homestore during the Class Period as members of Homestore's senior

management team and have personally participated in the events attributed to the confidential sources. In addition, Plaintiff's confidential sources occupied positions at Homestore that allowed them to possess information attributed to said confidential sources.

B. Summary of Scheme to Defraud the Investing Public

1. The Genesis of Homestore

88. In 1996, Stuart Wolff started Homestore's predecessor Realtor.com which listed real estate on the Internet. Wolff's first major hire was Peter Tafeen who became the "Prince of Deals." As with all Internet companies of the 1990's, Wolff and Tafeen knew that in order to become successful, Homestore would have to show revenue growth at least consistent with other Internet companies.

89. After Homestore went public in August of 1999, the need to generate and maintain revenue growth intensified. Wolff, Tafeen, the Individual Defendants and others sued herein, devised a scheme to fraudulently create the illusion of revenues through: (1) barter transactions, (2) revenue buying and, (3) round tripping transactions. Homestore used these transactions to perpetuate the illusion of revenue growth to meet or exceed its quarterly revenue projections, or to "make the bogie," and thereby maintain and/or inflate its stock price. In order to determine the amount of "revenue" that had to be created in a given quarter, Homestore's executives monitored the company's revenue progress on computerized "Risk & Opportunity" ("R&O") sheets. See, Exhibit E. The R&O's went through continual change right up to the end of each quarter, and were used to gauge how to "plug" any shortfall in the revenue target. The R&O sheets were also used to determine the quality (or lack thereof) of revenues. The Individual Defendants and others rushed to generate revenues if it looked like the "bogie" would not be reached. These R&O sheets were used not only by all senior executives at Homestore, including Tafeen and Wolff, but were also shared with PWC.

2. Barter Transactions

90. Historically, Internet companies engaged in transactions with each other in which they exchanged, or "bartered" rights to place advertising on each others' web sites. Barter transactions could involve an exchange of services, cash, or a combination of cash, equipment and/or services. From its inception, Homestore engaged in barter transactions with other companies.

91. In 1998, for example, Homestore and AOL entered into a conventional barter transaction. Homestore paid AOL $20 million in cash and gave AOL 1.5 million in warrants at various guaranteed prices in return for Homestore's right to be the exclusive online realtor for AOL. Homestore was able to recognize the revenue and AOL became an important partner in Homestore's scheme to generate revenue.

92. Government regulators and the accounting industry were concerned about whether companies were consistently reporting revenue for barter transactions. In November 1999 and January 2000, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board ("FASB"), issued EITF 99-17, in response to these concerns. In essence, the new accounting standard prohibits a company from reporting gross revenue from a barter transaction and requires the recognition of expenses. Before these new accounting standards took effect, PWC gave seminars at Homestore's offices and thereafter tutored the Individual Homestore Defendants and others on applicable accounting standards.

93. In contravention of these new accounting standards, the Individual Homestore Defendants and others continued to engage in recognizing revenue from barter transactions. Beginning in fiscal year 2000, after EITF Issue No. 99-17 went into effect, Homestore knowingly entered into fraudulent barter transactions with Defendants CityRealty.com ("CityRealty"), Classmates Online, Inc. ("Classmates"), PromiseMark, Inc. ("PromiseMark"), Privista, Inc.

("Privista") and Akonix Systems, Inc. ("Akonix"). In the first component or "leg" of each transaction, Homestore paid cash at an inflated price to each company in exchange for advertising and other services. In the second leg, each company recycled the cash received from Homestore back to Homestore as payment for Homestore's advertising and/or services also at inflated prices. The amount of the first leg of each transaction was almost identical to the amount of the second leg of the same transaction. Homestore then improperly recognized the inflated value as revenue on its financial statements.

3. <u>Buying Revenue</u>

94. Buying revenue is another form of a barter transaction where Homestore used cash, stocks or warrants to purchase advertising and/or services at inflated prices from third parties. The third parties would then buy advertising from Homestore at inflated prices. The result was that both companies improperly recognized the inflated values as revenues on their financial statements.

95. The template for buying revenue occurred as early as fiscal year 1998, when Homestore entered into such a transaction with RE/MAX International, Inc. ("RE/MAX"). In this transaction, Homestore paid RE/MAX $5 million for a five-year exclusive listing. RE/MAX then paid Homestore $5 million for web site development and hosting. The exclusive listing was recorded as an asset by Homestore while the money received for the website development and hosting was improperly recognized as revenue.

96. As the scheme became more sophisticated and cash became increasingly tight, Homestore revised the scheme to use stock and warrants in lieu of cash. In 1999, Homestore entered into this type of transaction with Wells Fargo Bank. In the first leg, Homestore gave Wells Fargo 500,000 warrants at a strike price of $20 per share, and Wells Fargo supposedly provided marketing services to Homestore. In the second leg, Wells Fargo paid Homestore $20 million over two years and Homestore received an exclusive position on Wells Fargo's web site.

97. By the first, second and third quarters of 2000, the frequency of Homestore's revenue buying transactions increased and the quality of the third party companies decreased as Homestore was only interested in generating revenues, rather than the quality of the revenues. Homestore entered into fraudulent revenue buying transactions with Defendants Dorado Corporation ("Dorado"), CornerHardware.com ("CornerHardware"), RevBox, Inc. ("RevBox"), Investor Plus, OnlineChoice.com, Inc. ("OnlineChoice") and SmartHome, Inc. ("SmartHome"). In the first leg of each transaction, Homestore agreed to provide web site advertising and pay cash for stock in each company. In the second leg, each company recycled the cash from Homestore back to Homestore as payment for Homestore's web site advertising at inflated prices and also provided stock in each company. Homestore then booked its recycled money as revenue.

4. Round Tripping with the Third Hidden Leg (Triangular Transactions)

98. By the first quarter of 2001, Homestore, the Individual Homestore Defendants, the Individual Defendants and others knew that in order to keep their scheme going, they would need additional companies as partners. Certain of these fraudulent schemes, designed by Tafeen and Eric Keller of AOL, involved three components, or three "legs" and that were triangular transactions.

i. AOL

99. Beginning in the last quarter of fiscal year 2000 and continuing into fiscal year 2001, Homestore and AOL entered into round trip transactions with: GlobeXplorer, Inc. (Q4 2000 & Q1 2001); WizShop.com, Inc. ("WizShop") (Q4 2000 & Q1 2001); PurchasePro.com, Inc. ("PurchasePro") (Q1 2001); Classmates Online, Inc. ("Classmates") (Q1 & Q2); and Investor Plus (Q2 2001). Each of these companies had products which were of minimal value, but they were willing to enter into these fraudulent transactions in return for a kickback.

100. In the first leg, Homestore paid these companies approximately $50 million in the aggregate purportedly for services, technology, advertising and/or content. The first leg was a sham transaction because Homestore received nothing of value in return but it was necessary to supply money to these companies so that they could fund the third leg.

101. In the second leg, AOL paid cash to Homestore for advertising. The third hidden leg was the bridge between these two transactions and was the "round trip" whcih was the *quid pro quo* for the deal. This is where the third party company used the money received from Homestore to buy advertising from AOL. In fact, however, AOL recycled that money back to Homestore which then improperly recognized the same as revenue.

ii. <u>L90</u>

102. In the second and third quarters of 2001, Homestore entered into triangular transactions with Defendant L90 and various third parties. The legs of these transactions were similar to the legs of the AOL/Homestore third party transactions described above.

iii. <u>Cendant</u>

103. Homestore also entered into a triangular transaction with Cendant in the first quarter of 2001 in which Homestore bought revenue in exchange for an ownership interest in Homestore. At that time, Cendant and Homestore solidified a strategic alliance that had begun in 1998. In the first leg, Homestore gave Cendant 21.4 million shares of Homestore stock (worth approximately $750 million), in return Homestore received 100% of the stock in two Cendant subsidiaries, Move.com and Welcome Wagon.

104. In the second leg, Cendant used the Real Estate Technology Trust ("RETT") and funded it with $95 million. RETT was the vehicle which Cendant used to funnel money to Homestore.

105. The third leg involved a deal between the RETT and Homestore whereby Homestore agreed to pay $80 million over two years in return for commercial products and services. These transactions lacked any economic substance because Homestore greatly overpaid for Move.com and Welcome Wagon and the RETT agreed to buy products without knowing the products it was buying.

106. As a result of these transactions, Cendant owned 20% of Homestore and placed two members on the Homestore board of directors. Since Cendant owned such a large share of Homestore, it was critical that revenues continued to flow to Homestore.

5. Insider Profiteering

107. The Individual Homestore Defendants and others personally profited from these round trips. Within days after quarterly revenues were reported and after the market reacted by increasing the price of Homestore stock, a trading window opened to allow company insiders to sell their stock; it is no coincidence that the insiders who participated in these round trip transactions regularly sold their stock immediately after the quarterly window opened and reaped millions of dollars in insider trading profits. See, Exhibit F.

6. Discovery of the Fraudulent Scheme

108. The fraudulent scheme to artificially inflate the stock was finally exposed when Homestore was forced to announce that revenues for all 4 quarters of 2000 and the first three quarters of 2001 had to be restated because Homestore had improperly recognized these bogus transactions. As a result of this restatement, Homestore's stock price plummeted. While the insiders reaped millions of dollars in profits, the Plaintiff Class members suffered massive losses in the value of their stock.

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C. The Revenue Recognition Transactions at Homestore

109. Like all Internet companies, Homestore is a revenue-driven company. In order to increase its valuation, Homestore must continually look to increase its revenues. Accordingly, there is enormous pressure on Homestore to show increasing revenues each quarter. According to Plaintiff's confidential sources who personally participated in these transactions and have direct knowledge of the circumstances of these transactions, in order to ensure increased revenues, Homestore undertook revenue generating transactions that were of "low quality" and presented more than acceptable risk. Plaintiff's confidential sources describe low quality transactions as those that have little or no long term strategic benefit to Homestore. Plaintiff's confidential sources recall, based upon personal knowledge that, it is these low quality revenue deals that evolved into Homestore's outright fraudulent conduct of buying revenue in order to meet Wall Street's earnings expectations.

110. Each and every named Defendant in this First Amended Consolidated Complaint directly participated in Homestore's scheme to deceive, manipulate, and/or defraud the market, by intentionally making statements or omissions known or believed to be false or misleading at the time, and under the circumstances made, with the intent of artificially inflating the price of Homestore's common stock in order to induce the sale or purchase of Homestore's common stock.

111. The inception of Defendants' scheme to deceive, manipulate and/or defraud the market formed in or about 1998 when Homestore entered into barter transactions or "back-and-forth" with other Defendant companies. These early "back-and-forth" transactions later evolved into the simultaneous, reciprocal "round-tripping" deals that formed the bases for the improper "revenue buying" or revenue recognition practices alleged in this First Amended Consolidated Complaint.

1. **<u>FISCAL YEAR ENDING 1998</u>**

i. **<u>Formation of the Relationship with AOL (Q2 FYE 1998)</u>**

112. The relationship between Homestore and AOL began in April of 1998 as Homestore was ramping up for its IPO. At Homestore, the project was referred to as "Project Everest." Project Everest was spearheaded by Defendants Tafeen and Wolff who were entering into distribution deals with a variety of Internet companies for the purpose of establishing Homestore's start-up business. By this time, Homestore was focused on eliminating competition and had succeeded in doing so except for Cendant's subsidiary Move.com.

113. With this backdrop, in April of 1998, Homestore purchased from AOL the exclusive right to have the only online real estate listing product available on the AOL web site. Homestore purchased this exclusive right for $20 million in cash to be paid in installments as well as $1.5 million in Homestore warrants at various strike prices.

114. Pursuant to this agreement, Homestore would be featured on AOL. Thus, when an AOL member would seek real estate related listings on the AOL web site, the AOL member need only click on the Homestore link and the member would be taken directly to the Homestore web site.

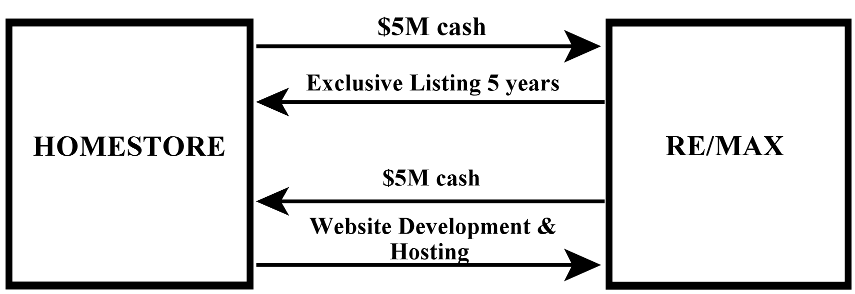
115. This relationship was reported in the *The New York Times*, which stated "AOL sold Homestore the right to promote its name and provide real estate information on AOL's service." <u>See</u> August 12, 2002, *The New York Times*, "AOL's Inventive Barter Deals Draw Scrutiny of Investigators." At the time, "AOL often swapped combinations of cash and online ads for in-kind payments of equity, equipment or advertising, then treated the value assigned to the in-kind payments as sales revenue." Homestore and AOL became the mutual beneficiaries of their deal resulting in the soaring price of Homestore shares.

116. As depicted in the following diagram, this simple and proper transaction would form the basis of later more complex and improper transactions.

ii. <u>Template for "Buying Revenue": RE/MAX International, Inc. (Q3 and Q4 FYE 1998)</u>

117. This transaction served as the template for Homestore's later improper transactions where Homestore would "buy revenue." In later transactions, Homestore's would "buy revenues" in the same manner as the following transaction with RE/MAX.

118. In 1998, Homestore entered into simultaneous reciprocal contracts with RE/MAX International, Inc. ("RE/MAX"). In the first segment of this transaction, Homestore paid RE/MAX $5 million in exchange for an exclusive listing for five years. In the second segment of the transaction, RE/MAX agreed to pay $5 million to Homestore for web site development and hosting. According to Plaintiff's confidential sources, each segment of the transaction was reflected in the same contract and both Homestore's Board of Directors and the company's auditors, PWC, were aware of this.



2. FISCAL YEAR ENDING 1999

i. Warrants For Revenue Transaction: Wells Fargo Bank (Q3 FYE 1999)

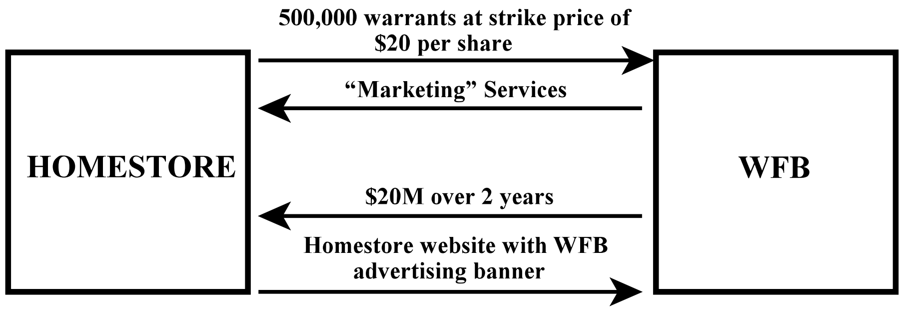
119. In 1999, Homestore entered into a transaction with Wells Fargo Bank that is a variation of the "buying revenue" transaction entered into with RE/MAX in 1998. According to Plaintiff's confidential sources, in this new form of transaction, Homestore traded its own warrants for revenue.

120. Homestore negotiated this early form of a reciprocal transaction with Wells Fargo Bank ("Wells Fargo") in August of 1999, near the time of Homestore's initial public offering. In the first leg of the transaction, Homestore gave Well Fargo 500,000 warrants at a guaranteed strike price of $20 per share, purportedly in return for receiving marketing services from Wells Fargo. In the second leg, or reciprocal component of the transaction, Wells Fargo paid Homestore $20 million over two years in exchange for an exclusive position on the Wells Fargo web site. Whether Wells Fargo provided consideration for the warrants was questionable.

121. According to Plaintiff's confidential sources, the pretext for the deal was the swapping of advertising for marketing services, functionally using stock warrants to purchase revenue. PWC knew about this transaction and, utilizing a particular pricing model in valuing warrants, allowed Homestore to book the $20 million as gross revenue over a period of two years. PWC did not ask whether the transaction was a swap and did not instruct Homestore to expense the warrants. PWC treated the two legs as unlinked transactions.

122. The transaction was reported in the August 12, 1999, *Realtor.com*, "Norwest Mortgage and Homestore.com, Inc. Announce Marketing Agreement" as between Homestore and Wells Fargo's subsidiary, Norwest Mortgage, Inc. ("Norwest"). The deal was described as a "multi-year marketing and advertising agreement" under which Norwest "will secure a variety of marketing placements

for its home finance products on all of HomeStore.com web sites" and Wells Fargo will advertise "consumer and commercial banking products on HomeStore.com sites." In return, Homestore was to acquire connections to Norwest and Wells Fargo "web sites offering services to real estate professionals, home builders and consumers."



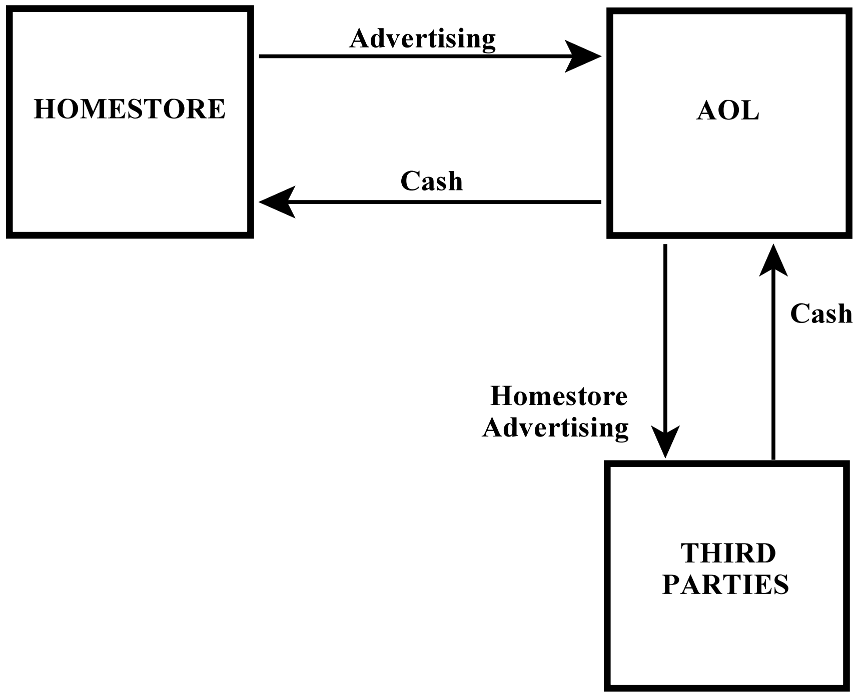
ii. The Second AOL Deal (Q1 FYE 1999)

123. During the first quarter of 1999, Defendants Homestore and AOL entered into a transaction that would, according to Plaintiff's confidential sources, later serve as a template for improper transactions with multiple legs.

124. As depicted in the diagram below, this transaction was intended to be a mutually beneficial, transaction with more than one leg. Namely, this transaction had two legs. The first leg involved the advertising reseller agreement between Homestore and AOL pursuant to which AOL would sell advertising on the Homestore web site and retain a commission as Homestore's sales agent. In the second leg, AOL would sell Homestore advertising to third parties who would pay AOL for the advertising. Under this system, AOL was the exclusive sales agent for Homebuilder.com, a subsidiary of Homestore.

125. This particular transaction generated significant discussion in the Finance and Business Development departments at Homestore regarding whether to recognize gross or net revenue for this transaction. According to Plaintiff's confidential sources, PWC was very involved in the accounting for this deal.

PWC was consulted because Homestore wanted to handle this transaction in accordance with accounting rules in particular EITF 99-19.



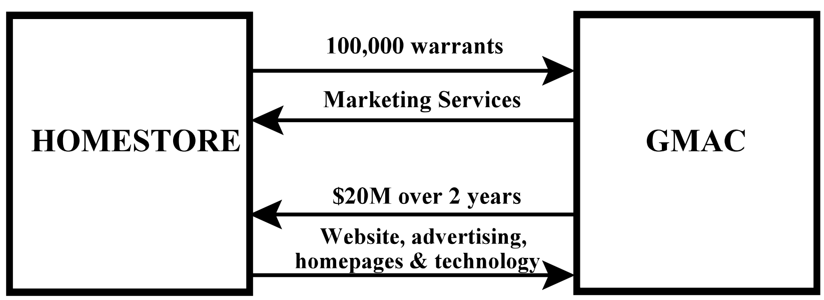
iii. <u>Homestore Buys More Revenue: GMAC (Q4 FYE 1999)</u>

126. This transaction is structured identically to the earlier Wells Fargo transaction where Homestore learned to buy revenue with its warrants. General Motors Acceptance Corporation ("GMAC"), the financial services subsidiary of General Motors Corporation entered into a marketing and e-commerce alliance with GMAC Mortgage and its sister company GMAC Homes Services, for a term of up to three years.

127. Homestore entered into a reciprocal transaction with GMAC that was intended to mutually benefit Homestore and GMAC. As with Wells Fargo, in the first segment of this transaction Homestore issued 100,000 warrants to GMAC at a specified strike price and, in return, Homestore was to receive marketing services from the GMAC Real Estate division (formerly the Better Homes and Gardens

Real Estate Network). In the second segment of this transaction, GMAC paid Homestore $20 million in cash over two years and, according to Homestore's November 8, 1999 Press Release, Homestore was to "provide web-based services to support GMAC's real estate network and retail mortgage operations"; in addition, "GMAC and its home services-related affiliates [was to] secure a variety of advertising placements for their real estate and home finance products on Homestore's family of web sites."

128. In Homestore's Press Release, the chairman of GMAC Home Services, Mike O'Brien was also quoted as saying that "this agreement sets the stage for GMAC to leverage technology and will greatly help us achieve our e-commerce delivery goals for comprehensive real estate services." Homestore's Wolff was "very pleased to have GMAC as a strategic partner. . . ."



129. According to Plaintiff's confidential sources, the valuation of the goods and services in the GMAC deal was questioned by PWC under Accounting Principles Board Opinion 29. PWC's concerns included the fact that (1) the first $10 million was paid over four quarters and expenses were not netted, (2) the deal was similar to the earlier Wells Fargo deal which also raised questions about the valuation of the purported goods and services provided, and (3) there was an option for a third year which Defendant Tafeen sought to exercise early in order to meet financial projections. Nonetheless, PWC allowed Homestore to recognize

$10 million in total revenue ($2.5 million per quarter) on a gross basis without netting out expenses.

3. FISCAL YEAR ENDING 2000

130. In fiscal years 1998 and 1999, Homestore entered into several types of transactions that would serve as the template for Homestore's later improper transactions. These earlier transactions depict Homestore's process of learning how to more and more aggressively record revenue. As the pressures to meet revenues increased and the Internet economy began to decline, it is these aggressive revenue recognition practices that evolved into the improper transactions of fiscal years 2000 and 2001.

i. Homestore Continues to Buy Revenue: Budget Group, Inc. (Q1 FYE 2000)

131. Again in 2000, Homestore used it's strategy of "buying revenue" as it had in the prior deals with Wells Fargo and GMAC. In this transaction, Homestore and Budget Group, Inc. ("Budget") entered into an illegal transaction which was intended to and did deceive, manipulate, and/or defraud the market, and had the effect of artificially altering the price of Homestore's stock.

132. Under the terms of the deal, Homestore provided Budget with 1,085,000 million shares at a guaranteed price of $64.50 per share and banner advertising on its web site. In return, Budget agreed to pay Homestore $1.5 million per year over 10 years and publicize Homestore nationally online and offline in, for example, the yellow pages and other print, television and radio advertisements, as well as on 45,000 of its Budget and Ryder rental trucks for 10 years.

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133. In its March 7, 2000 Press Release, Homestore lauded the Budget alliance as a ten-year "landmark agreement" which "further expands the Homestore.com reach into the $30 billion dollar moving services industry and exemplifies the company's hybrid business model of bridging online business services with traditional 'bricks and mortar' companies." According to the announcement, the public was advised that "Links from Homestore.com to Budget will include extensive home and apartment relocation information. Links from the Budget network to Homestore.com will include Homestore.com home and real estate content as well as various relocation tools. Homestore.com will also supply tools and technology for the Budget network of web sites, further extending Homestore.com's business-to-business service offerings to the home and real estate industry."

134. Budget's chairman and CEO, Sandy Miller, was noted in Homestore's announcement as stating that in joining a tangible business with an online business, "Budget Group and Homestore.com have hit a 'home' run with this 'bricks and clicks' alliance by bringing value-added services and more choices to consumers."

135. Furthermore, Wolff was quoted in the Press Release as stating, "We believe this alliance will add significant leverage to our revenue opportunities, and that the 144 billion impressions this powerful partnership provides will elevate Homestore.com brand awareness into the ranks of America's best known household names."

136. The Budget deal was reported to have created a real benefit for Homestore despite the fact that "other Internet companies were missing earnings or filing Chapter 11." See January 26, 2001, *The Industry Standard*, "Homestore Earns Big In A Down Season." That same article considered Homestore unique among its competitors, adding that "despite an evaporating market for online advertising, Homestore managed to increase its advertising revenue with contract wins from **Bank of America** (BAC), Kodak and **Budget Group** (BD) (emphasis in original). In addition, Defendant Wolff was quoted as saying, "I think the fourth quarter says a lot about us as a company . . . . In a difficult quarter we actually accelerated our revenue growth. There are probably only five other tech companies who were able to do that."

137. The Homestore deal with Budget did not involve cash; instead, Homestore gave Budget 1.085 million shares, which at the time of the deal in February 2000, were worth $70 million. However, if by March of 2002, the shares were not worth at least the $64.50 per share price, then Homestore would owe Budget the difference.

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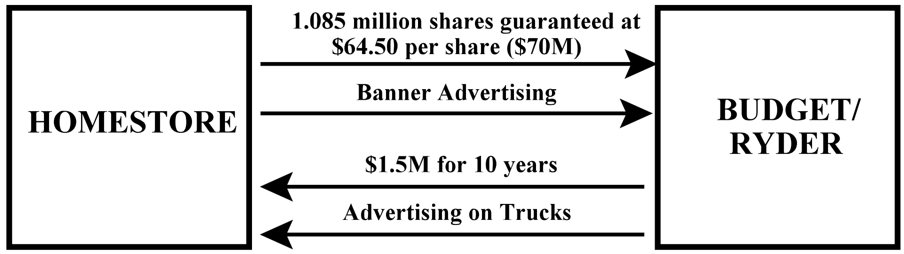


138. According to Plaintiff's confidential sources, Homestore's deal with Budget raised a number of accounting issues. One issue concerned the valuation of the banner advertising that Homestore provided for Budget. Another issue was whether giving Budget a guaranteed share price was in the best interests of Homestore, especially when after the transaction was executed, Homestore's share price dropped to $46 per share, far below the $64.50 strike price.

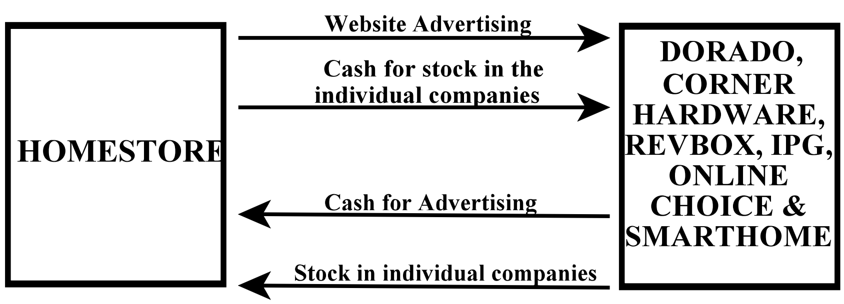
ii. Homestore's Equity Deals (Q1-Q3 FYE 2000)

139. In this permutation of Homestore's buying revenue transaction, Homestore began to purchase stock of seemingly worthless companies. In turn, the companies would use the money from their stock sale to purchase advertising on Homestore's web site.

140. According to Plaintiff's confidential sources, these companies included Dorado Corporation ("Dorado"), CornerHardware.com ("CornerHardware"), RevBox, Inc. ("RevBox"), Investor Plus, a subsidiary of IPG, OnlineChoice.com, Inc. ("OnlineChoice") and SmartHome, Inc. ("SmartHome"). Each of these companies was a direct participants in Homestore's scheme to deceive, manipulate, and/or defraud the market, by intentionally making statements or omissions that were known or believed to be false or misleading at the time and under the circumstances made, to artificially alter the price of Homestore's stock in order to induce the sale or purchase of Homestore's stock.

141. During the first, second and third quarters of 2000, Homestore entered into illegal transactions with Dorado, CornerHardware, RevBox, IPG, OnlineChoice and/or SmartHome, which transactions were intended to and did deceive, manipulate, and/or defraud the market, and had the effect of artificially altering the price of Homestore's stock.

142. In each of these transactions, Homestore invested in Dorado, CornerHardware, RevBox, IPG, OnlineChoice and/or SmartHome and provided a distribution deal in exchange for cash and stock. In the first leg of each of these transactions, Homestore agreed to provide web site advertising and pay cash for stock in each of the above-named Defendants. In the second leg or reciprocal component of each of these transactions, each of the above named Defendants agreed to recycle the cash paid by Homestore back to Homestore as payment for Homestore's web site advertising and provided stock in each of the above-named Defendants to Homestore. Homestore then booked its recycled money as revenue.



143. Homestore announced the Dorado deal in a May 31, 2000 Press Release, describing it as "a two-year, multi-million dollar technology and joint marketing alliance, offering enhanced capabilities to Homestore.com's mortgage lender customers and advertising on Homestore.com for Dorado.com's customers – some of the nation's top mortgage companies." According to Homestore, under the terms of the agreement "Dorado.com will pay Homestore to market and advertise its clients' services on the Homestore.com network, which attracts a

monthly audience of over 3.7 million users. In addition, Homestore.com will acquire equity in Dorado.com and integrate Dorado.com's Mortgage Tone technology – Web based software and professional tools for lenders – into its showcase I-LEND product." According to Wolff, "[w]e are committed to bringing all our customers the most innovative Internet-based solutions available today... Through Dorado.com's suite of products, we are offering mortgage lenders, real estate companies and their affiliated lending partners, powerful, fully integrated financial services tools to help grow their businesses online." In fact, the cash that Homestore paid for its equity interest in Dorado was recycled back to Homestore by Dorado as payment for advertising and marketing and booked by Homestore as revenue.

144. The market also noticed Homestore's deal with Dorado. In the May 31, 2000 Internetnews.com it was announced that the deal would put Dorado's financial software applications for lenders and its clients – top mortgage companies – on Homestore's web site. The Dorado deal was also a contributing factor leading Henry Blodgett of Merrill Lynch to issue a positive spin in his commentary on Homestore, projecting that the company would exceed its quarterly revenue estimates. See July 14, 2000 Merrill Lynch Comment.

145. Homestore's transaction with OnlineChoice was another example of an improper reciprocal transaction. In a July 26, 2000 Press Release announcing the strategic alliance, OnlineChoice was described as a "fast-growing company that uses the Internet to pool consumers nationwide to maximize their buying power for vital household services" including buying pools for electricity, natural gas, long-distance telephone and home security systems. According to the Homestore announcement, under the terms of the agreement, OnlineChoice purchased advertising and marketing services from Homestore and Homestore acquired an equity interest in OnlineChoice and the ability to offer its users the benefits of OnlineChoice's aggregate buying power. In reality, the cash that

Homestore paid for its equity interest in OnlineChoice was recycled back to Homestore as payment from OnlineChoice for advertising and marketing services and booked by Homestore as revenue.

146. In fact, according to Plaintiff's confidential sources, the majority of Homestore's investments in Dorado, CornerHardware, Revbox, OnlineChoice and SmartHome were worthless and the stock of each of the above-named Defendants was equally worthless.

147. According to Plaintiff's confidential sources, PWC reviewed each of the investment and distribution deals between Homestore and Dorado, CornerHardware.com, Revbox, Online Choice and SmartHome. These transactions were the essence of Homestore's scheme of "buying revenue." Defendant Wolff was allowed to execute deals under $5 million without advising Homestore's board of directors. Through these third party deals, Homestore invested approximately $40 million, which was recycled back to Homestore and recognized as revenue. According to the same sources, there was much debate between PWC and Homestore executives about how the company should report revenue from these deals, net or gross. After much debate, PWC deferred to Homestore and allowed it to recognize revenue as gross, not net, because PWC realized that there was intense pressure for Homestore to book revenue and inflate its stock price. It was not until later in 2000, that PWC became more strict about Homestore's accounting practices.

iii. iPlace and Other Deals (All Q's FYE 2000)

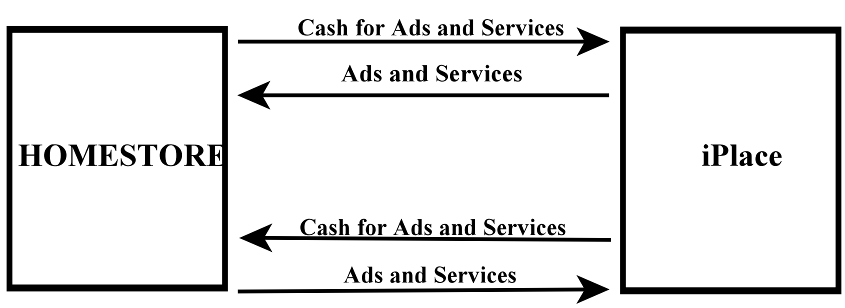
148. Defendants iPlace ("iPlace"), CityRealty.com, Inc. ("CityRealty"), Classmates Online, Inc. ("Classmates"), PromiseMark, Inc. ("PromiseMark"), Privista, Inc. ("Privista") and Akonix Systems, Inc. ("Akonix"), as described above, were direct participants in schemes to deceive, manipulate, and/or defraud the market, by willfully making statements or omissions that were known to be false or misleading at the time and under the circumstances made, or were believed

to be false or misleading at the time and under the circumstances made, to artificially alter the price of Homestore's stock in order to induce the sale or purchase of Homestore's stock.

149. According to Plaintiff's confidential sources who personally participated in and have personal knowledge of these transactions, during the first, Second, third and/or fourth quarters of FYE 2000, Homestore entered into illegal transactions with iPlace, CityRealty (Q1), Classmates, PromiseMark, Privista (Q4) and/or Akonix, which were intended to and did deceive, manipulate, and/or defraud the market, and had the effect of artificially altering the price of Homestore's stock.

150. Homestore entered into reciprocal, round trip transactions with iPlace, CityRealty, Classmates, PromiseMark, Privista and Akonix for their mutual benefit of Homestore.

151. In the first leg of each of these transactions, Homestore paid cash to iPlace, CityRealty, Classmates, PromiseMark, Privista and Akonix in exchange for advertising and other services. In the second leg or reciprocal component of each transaction, I Place, CityRealty, Classmates, PromiseMark, Privista and Akonix recycled the cash paid by Homestore back to Homestore as payment for Homestore's purported advertising and other services. Homestore then booked this recycled cash as revenue. The amount of the first leg of each transaction was almost identical to the amount of the second leg of the same transaction.



152. According to Plaintiffs' confidential sources, PWC had knowledge of the details of both sides of each of these transactions with iPlace, CityRealty, Classmates, PromiseMark, Privista and Akonix. In or about late 2000, PWC began to question the nature of these round tripping deals. PWC required the netting of certain, but not all of them, including the CityRealty deal in Q1 of FYE 2001. This caused Homestore to create more sophisticated means of hiding the reciprocal or round tripping leg.

iv. <u>The House & Home Deal: AOL (Q2 FYE 2000)</u>

153. In May of 2000, Homestore and AOL entered into a fraudulent transaction which was intended to and did deceive, manipulate, and/or defraud the market, and had the effect of artificially altering the price of Homestore's stock.

154. This transaction was a five-year multifaceted content, e-commerce and distribution alliance valued in excess of $200 million under which Homestore would be the exclusive distributor of home-buying and moving services across key AOL properties including AOL.com CompuServe, Netscape Netcenter & Digital City. Contemporaneous with and included in the terms of the marketing agreement, AOL established the "House & Home" channel for which Homestore would be the exclusive content provider, as well as a revenue sharing agreement to share revenue generated from the traffic on the House & Home channel. AOL would obtain 3.9 million shares of Homestore at the guaranteed price of $68.50 per share and Homestore paid AOL $20 million. The deal also called for Homestore to obtain a $90 million letter of credit which would be available to AOL if Homestore's stock did not meet the guaranteed price of $68.50.

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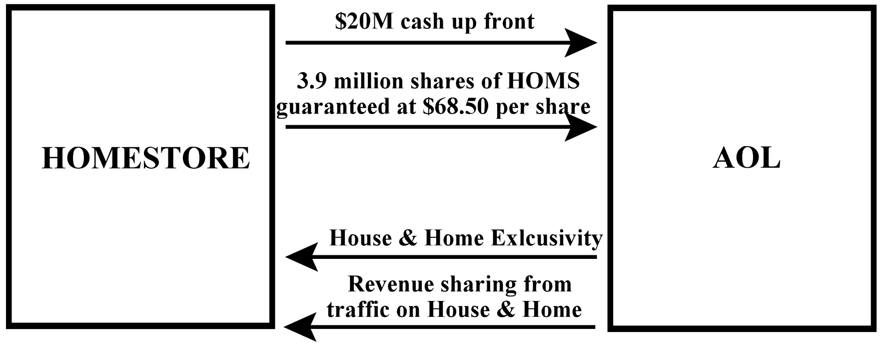


155. The Homestore - AOL deal received a great deal of news coverage. According to a Homestore May 1, 2000 Press Release, AOL and Homestore "reached a new five-year multifaceted content, e-commerce and distribution alliance valued in excess of $200 million, to provide the most comprehensive source of home and real estate content to several key AOL brands." The Press Release continues: "One highlight of the AOL/Homestore.com alliance will be the establishment of a new home-related channel on AOL that will provide its more than 22 million members with a more convenient and content-rich online area to find home-related information, tools and services. . . Under terms of the new alliance, Homestore.com will become the exclusive national provider of professional home and moving services in home-related areas across AOL . . ." Robert Pittman, President and COO of AOL praised the deal: "Homestore.com is the leading company in the online home and real estate industry, and having easy access to its property listings, services and content will be a real benefit to our members and users of our Web-based brands." In addition to paying AOL $20 million and giving AOL 3.9 million shares of stock (guaranteed at $68.50 per share), Homestore also obtained a $90 million line of credit guaranteeing the performance of the stock. AOL and Homestore also agreed to share revenue that Homestore received from advertising sales on the America Online web site "House & Home." AOL's share price increased as a result of the announcement of the deal.

156. The industry was also watching the Homestore - AOL deal. According to industry observers, "From AOL's perspective, it's a no-lose arrangement; if the stock goes to $100, AOL wins; if the stock goes to $10, AOL still gets cash or stock payment of $68.50 a share. See May 28, 2001 *The Industry Standard*, "Analyze Its Stock Deals and Homestore.com's Dramatic Success Doesn't Look So Good Anymore."

157. Research analysts at Robertson Stephens Inc. added their optimistic spin on the AOL deal in the August 24, 2000 Robertson Stephens Internet Research report. Believing that business was "going great" for Homestore and appeared to be "getting stronger," analysts noted their expectation that Homestore would launch its home channel on AOL by late September and that the new channel would double the traffic across the Homestore network. This was based on their belief that Homestore at that time averaged 4 million unique users per month and that even AOL smallest channels averaged similar traffic. Based on what Homestore reported in Q3, the analysts also believed that their estimated 6% revenue increase for the next quarter was "conservative." Completely enamored with Homestore, the analysts also expected that Homestore shares would surpass the $68 per share strike price guaranteed to AOL.

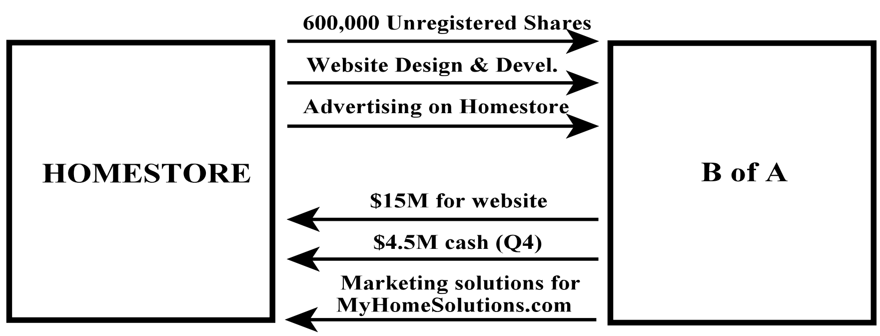
158. According to Plaintiff's confidential sources, this transaction between Homestore and AOL started to dissatisfy Homestore as Defendant Tafeen believed that AOL was not delivering on the number of hits on the House & Home channel and was not performing under the agreement. This led Tafeen to believe, and assert, that AOL owed Homestore quality revenues for future deals. This transaction was improper because Homestore used it's stock to buy revenues from AOL.

v. Bank Of America I (Q4 FYE 2000)

159. During the fourth quarter of 2000, Homestore entered into an illegal transaction with Bank of America. The Bank of America deal was structured over

two quarters. The first segment of this transaction involved Homestore giving Bank of America 600,000 unregistered shares, web site design and development services and advertising on Homestore's web site. In return, the second segment of the transaction involved Bank of America paying Homestore $15 million for the web site design and $4.5 million in cash and marketing services for MyHomeSolutions.com.

160. The $4.5 million advance was dependent upon the completion of the rest of the deal. Giesecke, Shew, and DeSimone sought the advice of PWC senior audit partner Richard Withey about the structure of the deal, and how to structure the deal so that Homestore could recognize the $4.5 million as revenue in the fourth quarter.



161. According to Plaintiff's confidential sources, Homestore explicitly requested that Withey review this transaction. PWC reviewed and approved the transaction with Bank of America. This transaction was the subject of Homestore's restated financials.

162. According to the May 28, 2001 article in *The Industry Standard*, Homestore's appearance of a "stellar success has come at great cost – a cost not always reflected in Homestore's pro-forma results. Homestore has been bold in its use of unregistered stock to pay for operating expenses. The company has doled out more than 6 million shares to marketing partners and real estate brokerages." Although he recognized the poor quality of these deals in meetings with Wolff,

Tafeen and Shew, Giesecke defended this practice by noting that "Most technology companies report pro-forma results . . . These are not just stock-for-revenues deals. We are creating partnerships here."

163. The industry did not appear to agree with Homestore's rationale. According to that same article, the Homestore deal with Bank of America was a typical stock-for-revenue transaction and suggested that this type of transaction can sometimes have a misleading effect on the market:

> On April 10, the two companies announced a '$10.5 million marketing and Web-services agreement' that would allow Homestore access to B of A's 3.2 million online bankers. Analysts and investors figured that this meant some $10.5 million in revenues to Homestore, and the stock surged 22.8 percent in a day. But in the company's quarterly report on May 15, Homestore reported giving Bank of America $13.4 million worth of stock for the deal. The company signed similar stock deals with Broker Gold, Budget Truck, GMAC, Norwest and a host of multiple real-estate listing services.

vi. <u>GlobeXplorer (Q4 FYE 2000 and Q1 FYE 2001)</u>

164. Although this improper deal was never consummated, Homestore and GlobeXplorer, Inc. contemplated a transaction for the mutual benefit of Homestore and GlobeXplorer. According to Plaintiff's confidential sources, Tafeen and Clayton Chan, Vice President of the Strategic Alliance Group at Homestore, negotiated the GlobeXplorer deal.

165. Execution of the transaction was terminated by Homestore. According to one of Plaintiff's confidential sources, GlobeXplorer was unhappy that Homestore backed out of this transaction and threatened to expose Homestore's for participating in improper transactions at the Robertson Stephens, Inc. investor's conference in San Francisco, California, believed to be on or about February 13, 2000. Homestore was warned that representatives of GlobeXplorer intended to publicly expose Homestore's improper round trip deals at the conference if the cancelled deal was not consummated. Chan apparently informed DeSimone of this threat, who, in turn, informed Shew. To avoid the threat of exposure, Tafeen proceeded with the payment to GlobeXplorer. Ultimately,

Homestore paid between $100,000 to $200,000 to appease GlobeXplorer. During the investor's conference, Shew was not publicly confronted by any representatives of GlobeXplorer nor were any remarks made by GlobeXplorer about Homestore.

4. FISCAL YEAR ENDING 2001

i. The Move.com Acquisition: Cendant (Q1 FYE 2001)

166. In October 2000, Homestore announced that it would acquire Cendant's online real estate web site, Move.com. The Department of Justice was investigating anti-trust issues that had come to the attention of the DOJ by means of complaints made by members in the real estate industry. The DOJ expanded its investigation upon the announcement of Homestore's intent to acquire Move.com. The inquiry into the acquisition was not unexpected since the deal was combining the number one and two online real estate sites. The deal was suspended pending an investigation. On February 20, 2001, Homestore issued a press release entitled, "Homestore.com, Inc. Completes Acquisition of move.com," announcing that the deal had been cleared by the DOJ.

167. Thereafter, Homestore and Cendant completed their complex multi-legged transaction, centered on Homestore's purchase of Move.com. In the first leg of the transaction, Homestore gave Cendant 21.4 million shares of Homestore stock worth approximately $750 million, in return for receipt by Homestore of 100% of the stock in two Cendant subsidiaries, Move.com and Welcome Wagon. See December 1, 2000 Realtor.org: "Dramatic Moves At Homestore.com Will Keep REALTORS at the Forefront of the New Economy". The second leg involved Cendant funding of the Real Estate Technology Trust ("RETT") with $95 million. The third, return leg of the transaction involved a deal between the RETT and Homestore whereby RETT agreed to pay $80 million over two years in return for commercial products and services such as iLead and iPIX.

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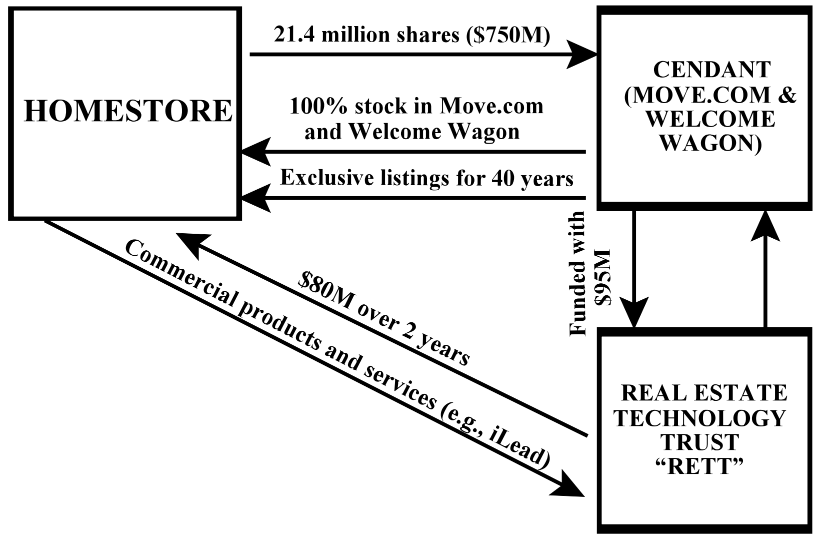


168. As a result of the Move.com and Welcome Wagon acquisition, Cendant obtained ownership of 20% of Homestore and two seats on the Homestore Board of Directors which were occupied by the Chairman and CEO of Cendant's Real Estate Group, Richard Smith and the CEO of Cendant's Internet Group, Sam Katz.

169. Homestore's acquisition of Move.com fulfilled Wolff's vision of market dominance and solidified its position as the leading source of online real estate listings. Through the acquisition, Homestore's Realtor.com obtained exclusive online use of aggregated listings of the nation's largest real estate brands. See December 12, 2000 Realtor.org: "Dramatic Moves At Homestore.com Will Keep REALTORS at the Forefront of the New Economy"; December 25, 2000 *The Richmond Times Dispatch*: "Selling By Executive At Low Prices Ominous Sign".

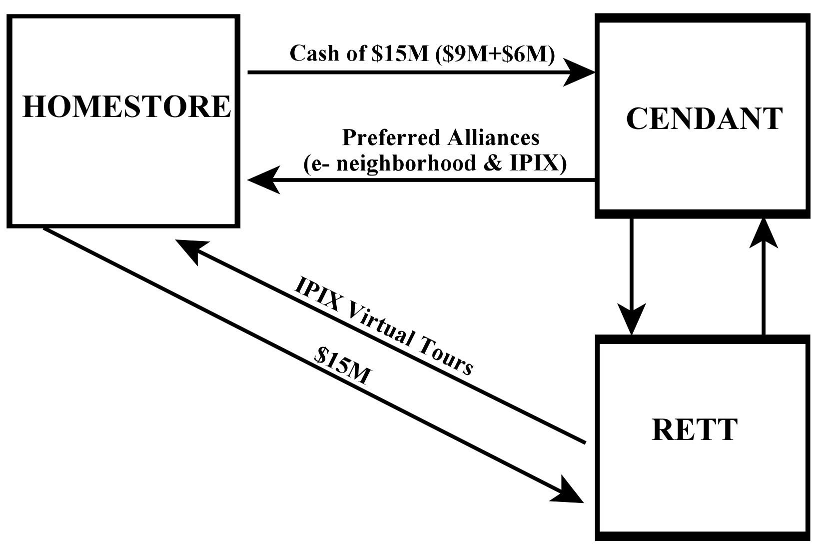
170. The three legs of the Cendant-Homestore transaction were simultaneous and contingent upon each other. The Homestore and RETT transactions were between related parties and as such, were not arms' length transactions. According to Plaintiff's confidential sources, Homestore's auditor, PWC, was concerned enough about the reciprocal nature of this deal to get its national office involved.

ii. Tafeen's Hidden Contract (Q2 and Q3 FYE 2001)

171. During fiscal year 2001, Homestore entered into an illegal transaction with Cendant in which Homestore sold RETT $15 million in virtual tours for use by Cendant. This sale occurred in two quarters. The first sale took place in June 2001 and was for $9 million. The second sale occurred on September 28, 2001 and was for $6 million

172. According to Plaintiff's confidential sources, Tafeen consulted Shew on how to structure these transactions so that revenue could be recognized. Tafeen informed Shew that Cendant was willing to participate in the deal, but wanted an agreement from Homestore to purchase $15 million in products from Cendant in the first quarter of 2002. Shew instructed Tafeen not to sign any agreement to "give-back" the $15 million because PWC would not allow Homestore to recognize the revenue if the transactions appeared to be simultaneous.

173. Nevertheless, Tafeen executed this illegal transaction agreeing to "give back" $15 million to Cendant in the first quarter of 2002.



iii. AOL (Q1 FYE 2001)

174. In the end of the first quarter of 2001, Homestore entered into a series of illegal transactions concocted by Tafeen and Keller, with the knowledge and approval of Colburn, whereby Homestore and AOL would conduct triangular transactions with third party vendors. Negotiations about the first of these transactions coincided with discussions between Homestore and AOL about a potential merger between the two which would have consolidated the companies and dissolved any evidence of improper round trip transactions.

175. The triangular deals involved one leg whereby Homestore would pay third party vendors for some service or product that Homestore had no real use for, a hidden second leg wherein the quid pro quo for the first leg was that the third party vendor would buy Homestore advertising with AOL, and a third leg whereby AOL would "round trip" the money which started with Homestore back to Homestore.

176. During the first quarter of 2001, Homestore recognized approximately $15 million in revenue from these fraudulent round trip transactions. Third party companies involved in these AOL deals included PurchasePro, InvestorPlus, FX Consultants, Classmates.com, Wizshop and Easy Roommates.

177. These transactions are the culmination of the evolution of transactions that began in April of 1998 as described above. At their core, each of these illegal transactions is structured to buy revenue. It was agreed by the participants in this transaction that AOL would not document the agreement by the third party vendors to buy advertising from AOL.

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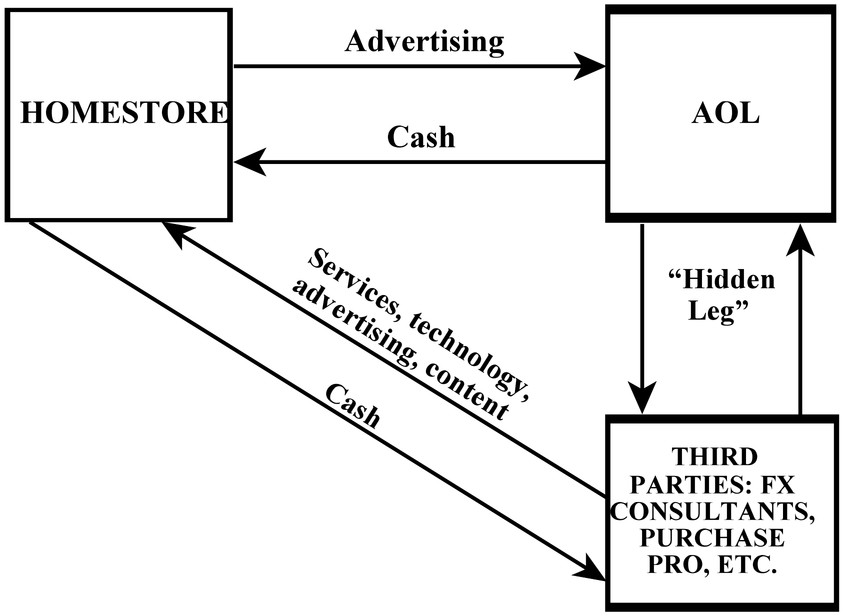
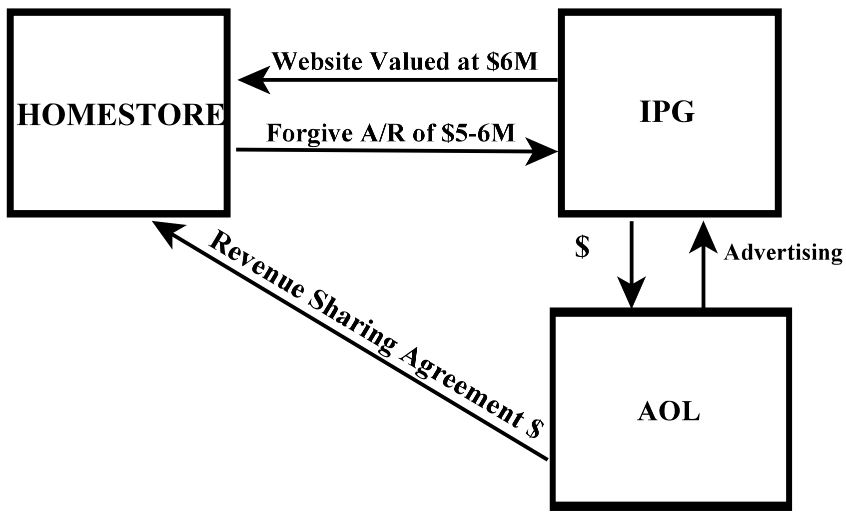


iv. **Investor Plus (Q2 FYE 2001)**

178. As Homestore's desperation for revenue mounted, it turned to increasingly more aggressive and improper transactions to find revenue. In the transaction, depicted below, Homestore and Investor Plus, a subsidiary of IPG, a Canadian Company traded on the Toronto Exchange, entered into an illegal round trip transaction for their mutual benefit. According to Plaintiff's confidential sources, Homestore sought to recover an account receivable from IPG totaling between $5 and $6 million that it was owed by IP.com, a spin-off that Investor Plus sold to Homestore.

179. Defendant Tafeen devised a transaction to remedy the situation. In the first leg of the transaction, Homestore agreed to transfer the spun-off assets back to IPG and forgive IPG's accounts receivable due Homestore; in exchange, IPG agreed to give Homestore a web site valued at $6 million, the amount of the forgiven accounts receivable. In the second leg of the transaction, IPG agreed to purchase advertising from AOL and, in turn, AOL agreed to purchase advertising from Homestore; IPG did not have to pay the accounts receivable to Homestore.

Under a revenue sharing agreement between AOL and Homestore in the third leg of the transaction, each company separately booked their purported revenue.



180. Substantiating the $6 million value of the IPG web site given to Homestore was contrived by generating an internal estimate at Homestore and by obtaining estimates from two vendors. This process was witnessed by Homestore employees Kevin Malloy, Dean Denhart, Steve Bove and Jason Boling.

181. In addition, under heavy scrutiny from PWC, David Heaberlin of IPG wanted to disclose this transaction to PWC. However, after discussing with Tafeen and Kalina and other Unnamed Participants, whether disclosure of the transaction and of AOL's advertising purchase, IPG relented to Homestore's request and "de-linked" the AOL leg of the transaction.

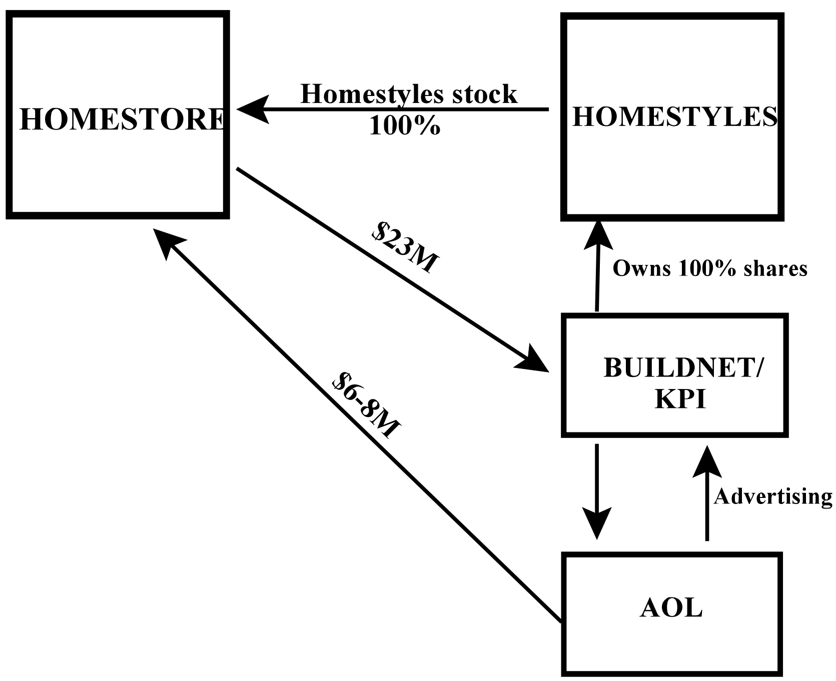
v. Homestyles Acquisition (Q2 FYE 2001)

182. In this transaction, Homestore entered into a round trip transaction that combined elements of the earlier stock for revenue and multi-leg transactions. This transaction was personally negotiated and orchestrated by Allan Merrill.

183. In the first leg of the transaction, Homestore paid Buildnet approximately $23 million in cash to acquire its subsidiary, Homestyles. In the second leg of the transaction, Buildnet paid $5 to $6 million to AOL for

advertising with the understanding that Homestore would assume this liability; the accounts payable for the advertising went with the Homestyles acquisition.

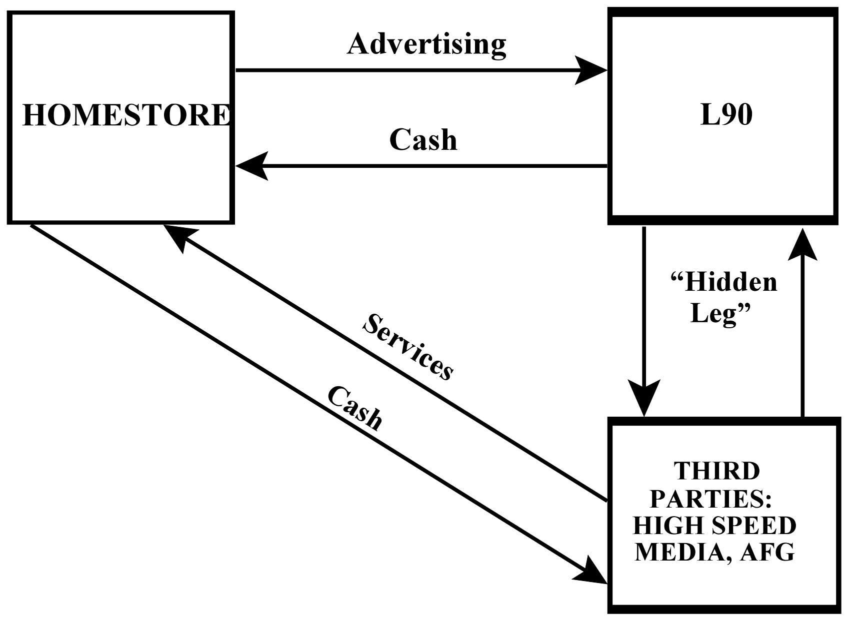
184. Buildnet purportedly handled this deal through its KPI division in order to hide the transaction from PWC; otherwise, PWC would have seen on revenue sharing reports that Homestore was involved with Buildnet or Homestyles. Consequently, Defendant Merrill decided to have other affiliates of Buildnet purchase advertising on AOL. In the third leg of the transaction, AOL paid $6 to $8 million to Homestore as part of the revenue sharing agreement and Homestore recognized that amount as revenue.



vi. L90 (Q2 AND Q3 FYE 2001)

185. In this round trip transaction, Homestore followed its now well established pattern. Homestore and L90 entered into illegal round trip transactions with third party companies including, without limitation, Hi-Speed Media. In the first leg of the transactions, Homestore paid cash to the third party in exchange for purported goods and/or services. In the second, or "hidden leg" of the

transactions, the third party company would pay cash to L90 in exchange for purported goods and/or services. In the third leg, L90 recycled the cash back to Homestore through the third party's "purchase" of advertising. Homestore, would then recognize this cash "payment" from L90 as advertising revenue.



D. False Statements Issued by Homestore and Analyst Reports Based Thereon

186. Based on and with knowledge of their improper conduct described above, Defendants publically hyped Homestore's revenue growth in an effort to inflate the value of Homestore's common stock. This conduct started as early as 2000.

187. On January 13, 2000, *RealtyTimes* published an article entitled, "Peter Tafeen: Prince or Piranha of Homestore?" Tafeen is described as a "Master puppeteer who pulled many of the most important strings in manipulating Homestore's massive success." When asked why he does it, Tafeen replied, "We want to be the biggest and the best. I compare us not to other real estate

companies, but to the greatest companies in the world. I look at UPS, GE, Microsoft, AOL and others and that is where we want to be."

188. On January 24, 2000, Homestore issued a press release reporting its record revenue and operating results for the fourth quarter and year ended December 31, 1999. Wolff commented on the report saying, "Our fourth quarter and 1999 operating results extend our strong growth trend at Homestore.com."

189. On February 17, 2000, Homestore issued a press release announcing its strategic alliance with Smarthome.com, Inc., stating that Homestore made a 10% investment and entered into a multi-year marketing and distribution agreement with Smarthome.com.

190. On March 7, 2000, Homestore issued a press release announcing that it had entered into a ten-year strategic alliance with Budget Group, Inc. Under the alliance, Homestore would receive advertising in various media, provide 1,085,000 shares of Homestore common stock to Budget.

191. On March 24, 2000, Homestore issued a press release announcing the expansion of its agreement with GMAC, providing that Homestore would receive an additional $10 million to support the expansion of GMAC's real estate, relocation and home finance units. This agreement added to the existing two-year $20 million agreement between Homestore and GMAC, entered into in November of 1999.

192. On April 7, 2000, Merrill Lynch analysts Henry Blodget and Kirsten Campbell reported that Homestore's current trading level (16 times Merrill Lynch's 2001 revenue estimate of $215 million) was attractive in relation to "other category killers such as EBAY at 50X 2001 revenue estimates." Merrill Lynch analysts "believe that Homestore's fundamentals are strong and improving, and that the company will grow into a significantly higher valuation."

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193. On April 11, 2000, Homestore issued a press release announcing that Allan Merrill was appointed as President of HomeBuilder.com, the engine for Homestore's "New Homes" site.

194. On May 1, 2000, Merrill Lynch's analysts Blodget and Campbell issued a report stating that the five year deal announced between Homestore and AOL was "a major positive for Homestore." The deal reportedly had a total value of $90 million, $20 million of which was paid for in cash, the rest was in Homestore stock. The agreement required Homestore's stock to reach and maintain a price per share of $68.50 over three years. If this requirement was not met, Homestore would have to pay AOL $110 million in cash. Merrill Lynch analysts reported that they thought the stock could reach $68 per share by the required date. The report forecast that Homestore's stock would beat Merrill Lynch's revenue estimate of $30 million and, therefore, would also beat their estimate of a loss of $0.17 per share. The report stated that "HOMS shares have been exceptionally weak as of late. We think [Homestore] shares are attractive, trading at 9x 2001E revenues." Merrill Lynch rated Homestore "Buy."

195. On May 3, 2000, after the close of the market, Homestore issued a press release announcing its purported "record" revenue for the first quarter of 2000, ending March 31, 2000. In pertinent part, Homestore stated:

> Revenues for the quarter increased 271% to $38.6 million over pro forma revenues of $10.4 million for th first quarter of 1999 and 38% over pro forma revenues of $28.1 million for the fourth quarter of 1999.
>
> Revenue growth in the first quarter was driven by both increased revenue from professional subscriptions **as well as an increase in advertising revenue... Growth in advertising revenue was primarily driven by increased sponsorships and expanded strategic alliances throughout the quarter**.
>
> "Our first quarter results confirm that Homestore.com's momentum continues to build," said Stuart Wolff, the company's chairman and chief executive officer. "The strong results across all of the key drivers of our business confirm that we are further extending our leadership position in this very large market." Wolff continued, "Based on the tremendous momentum that we have established, we anticipate the company will reach cash profitability earlier than expected." (Emphasis added).

196. On May 4, 2000, in response to Homestore's after hours press release, Merrill Lynch analysts Blodget and Campbell wrote that, "Homestore.com reported a great quarter, easily exceeding estimates." The news that Homestore beat revenue predictions prompted Merrill Lynch to raise its revenue predictions for 2000 from $139 million to $173 million, and the 2001 estimate from $215 million to $258 million. In addition, the report predicted that Homestore would achieve profitability two quarters earlier than expected, i.e., the company would be profitable in the first quarter of 2001. These increased revenue predictions led to a revised valuation for Homestore's stock. The company's losses were revised from a projected loss of $0.42 per share to a loss of $0.28 per share, and estimated earnings per share for 2001 were increased from $0.03 to $0.33. Blodget and Campbell stated that Homestore's "price objective remains $110, or 38X 01E revs."

197. On May 31, 2000, Homestore issued a press release announcing its joint marketing and advertising strategic alliance with Dorado.com. The two companies formed the two-year, multi-million dollar alliance, in which Dorado.com would pay Homestore for advertising and Homestore would gain equity in Dorado.com.

198. On June 12, 2000, Homestore issued a press release announcing its acquisition of Top Producer Systems, Inc. Homestore acquired Top Producer for approximately $24.2 million in Homestore common stock and cash. As a part of this deal, the founding shareholders of Top Producer were entitled to receive up to $16.2 million over the following four years if certain performance targets were met.

199. On June 19, 2000, Homestore issued a press release announcing a strategic financing and web marketing agreement with Investorplus.com. RealSelect, Inc., a Homestore subsidiary, invested in Investorplus.com and became a 10.5% equity partner. Investorplus would use the proceeds for the development

of its e-commerce platform. Additionally, a comprehensive web marketing agreement was reached between Homestore and Investorplus.com and a co-branded web site would be launched later in the summer.

200. On July 14, 2000, a Merrill Lynch report stated that they expected Homestore's second quarter results, reported on July 19, 2000, to "easily exceed our estimates." The report stated that:

> 1. *Revenue.* We believe our revenue estimate is very conservative, up 5% sequentially and 185% year/year to $40 million. Our optimistic case calls for $48 million, helped by new deals announced this quarter. . . .
>
> 2. *Professional Subscribers*. We estimate 10,000 new subscribers, from 12,000 in 4Q for a total of 117,000. Revenue per average subscriber is down 8% to $208 from $225, though we believe this metric could be flat to up due to B2B revenue.
>
> 3. *Gross margin*. We expect it will be 73.4%, up from 72.6% in 1Q, for gross profit of $30mil.

201. The Merrill Lynch report stated "we expect the company to easily exceed our estimates of a loss of $0.09 EPS [earnings per share] on $40.5 million of revenue." This forecast was based on Homestore's announcement of "many new 2-3 year guaranteed revenue deals." The report indicated that 60% of Homestore's advertising revenue came from similar 2-3 year contracts.

202. On July 19, 2000 Homestore released second quarter results in a press release entitled, "Homestore.com, Inc. Reports 252% Growth in Second Quarter Revenue," announcing that their revenue for the quarter had "increased." In pertinent part, Homestore stated:

> Revenues for the [second] quarter [which ended June 30, 2000] increased 252% to $50.2 million over pro forma revenues of $14.2 million for the second quarter of 1999 and 30% over revenues of $38.6 million for the first quarter of 2000. The company's gross profit margin improved 74% for the quarter, up from 63%, on a pro forma basis, for the second quarter of 1999 and from 73% for the first quarter of 2000. Pro forma net loss for the quarter was $2.8 million, or $0.03 per share. That compares to a pro forma net loss of $20.9 million, or $0.36 per share, for the second quarter of 1999 and $10.0 million, or $0.14 per share, for the first quarter of 2000.
>
> On a GAAP basis, the company's revenues for the quarter were $50.2 million, compared to $11.0 million for the second quarter of 1999 and $38.6

> million for the first quarter of 2000. Net loss for the quarter was $24.7 million, or $0.31 per share, compared to $18.3 million, or $0.75 per share, for the second quarter of 1999, and $29.2 million, or $0.39 per share, for the first quarter of 2000.
>
> **Increased revenue from both professional subscriptions and advertising drove overall revenue growth in the second quarter.** Revenue growth from professional subscriptions was primarily due to an increase in the number of professionals on the Homestore.com™ family of web sites. Professional subscriptions rose to almost 122,000 at June 30, 2000, representing increases of 64% and 14%, compared to totals at June 30, 1999 and March 31, 2000, respectively. **The increase in professional subscriptions included the Realty Executives International, Inc. corporate sponsorship agreement signed in May. Growth in advertising revenue was primarily driven by an expansion in sponsorships and strategic alliances during the quarter.**
>
> Site usage also grew substantially during the second quarter. For April and May 2000, the monthly average number of unique users visiting the Homestore.com network rose to 3.6 million, a 51% increase over the second quarter of 1999 and a 25% increase over the first quarter of 2000. (1) During April and May of 2000, each unique user spent an average of 26.1 minutes per month on the network, a 17% increase over the second quarter of 1999 and consistent with the first quarter of 2000. (2) Page views were 626 million for the quarter and 1.2 billion homes were viewed on the Homestore.com network during the quarter, bringing the cumulative number of homes viewed since the company's inception to 5.9 billion.
>
> "Another excellent quarter of execution by our team," said Stuart Wolff, the company's chairman and chief executive officer. "We are furthering our leadership position to both consumers and professionals as we build out the online home and real estate marketplace." Wolff added, "Based on the strength of our financial performance, we expect the company to reach cash profitability in the fourth quarter this year, which will place Homestore.com in an elite group of Internet companies." (Emphasis added).

203. The release of this July 19, 2000 statement caused Homestore's stock price to soar. The following trading day, Homestore's stock price increased by more than $7.00, from $30.75 to $38.50. At the time, this amounted to a 25% increase in the value of the stock. However, as alleged below, according to Plaintiff's investigation, Homestore's July 19, 2000 press release was materially misleading because Defendants knowingly overstated the on-line advertising revenue it received during the second quarter of 2000. Certain advertising transactions, that were recognized as revenue, should not have resulted in revenue recognition because they were barter transactions, the buying of revenue or "round tripping."

204. Basing their reports on Homestore's July 19, 2000 announcement, several analysts issued reports advising the investing public to buy Homestore common stock. Among those were Robertson Stephens analysts, Michael Graham and Jay P. Leupp, who on July 20, 2000, issued a report entitled "Homestore.com: Strong Q2 results. Profitability coming faster than expected. Raising estimates substantially. Buy Rated." Robertson Stephens reported that Homestore's revenue upside was driven by strong demand for Homestore's professional services and "strong online advertising sales targeted toward the home buying demographic." In addition, Robertson Stevens reported that:

> We believe this is only the beginning of our ability to raise estimates and expectations for [Homestore stock]. We view the company as occupying a central and leading position in one of the largest sectors of the U.S. economy. We believe the company's opportunity is open-ended. Buy rated.

205. Similarly, on July 20, 2000, Merrill Lynch analysts Blodget and Campbell, in a report entitled "Blowout 2Q: Raising Estimates and accelerating Profitability, Again–Part 2," favorably reported on Homestore's stock:

> Homestore.com reported great 2Q results. We are raising estimates (accelerating profitability by 1 quarter to 4Q) and maintaining rating. We maintain high confidence in the company's prospects and reiterate our Buy rating.
>
> 2000E revenue goes from $174mm to $204mm, 2001E from $259mm to $300mm. 2000E EPS loss goes from d$0.28 to d$0.16, and 2001E from earnings of $0.33 to $0.35. We believe there is still significant upside to the new [estimates].

Merrill Lynch's report then went on to say that Homestore's price to EPS was "very attractive" for a "sector leader with continued strong growth." Merrill Lynch gave Homestore a quarter grade of "A" for the second quarter of fiscal year 2000.

206. A third report was issued on July 20, 2000 by Chase H&Q analysts Genni Combes and Matthew Gustke, who stated that Homestore's second quarter 2000 results were "significantly above expectations." The report entitled "Very Strong Q2 for Homestore. Profitability to arrive in Q4," reported that Homestore's

revenue growth of 252% year per year was driven by an ad/sponsorship increase of roughly 494% year per year. The report projected that Homestore would achieve profitability in the fourth quarter of 2000, versus their previous estimate of profitability for the first quarter of 2001, and adjusted revenue expectations up $30 million to $201 million and reduced EPS loss assumptions. In addition, Chase H&Q increased Homestore's 2001 forecasted earnings to $285 million and stated that there was "significant room for upside." The report stated that the addition of large ASP customers and the launch of an AOL channel in the third quarter had "the potential to act as near-to medium-term catalysts for shares of [Homestore]."

207. UBS Warburg analysts John Stanley and Marisol Myung issued their report on July 21, 2000, stating that "Homestore's dominance of traffic in the home space is central to its drive to produce revenues from advertisers on its content-laden vortal [virtual portal], and from home professionals in its emerging role as the leading vertical ASP."

208. On August 4, 2000, Homestore filed its June 30, 2000 financial results with the SEC using a Form 10-Q. In its 10-Q Homestore reiterated the financial results reported in its July 19, 2000 press release. Homestore represented that the financial statements were prepared in accordance with GAAP, when, in fact, as alleged below, the quarterly and annual financial statements during the relevant period were not prepared in conformance with GAAP, nor were the audits performed in accordance with GAAS.

209. On August 17, 2000, Merrill Lynch analysts Blodget and Campbell reported that, based on their talks with Homestore that week, they believed Homestore was on track to report strong results in the third quarter of 2000. In addition, they raised revenue estimates $6 million to $210 million for fiscal year 2000 and increased profit estimates $20 million to $320 million for fiscal year 2001. Merrill Lynch emphasized that these adjusted estimates were "still conservative," and reported that they expected Homestore to post its first profit of

$0.01 per share in the fourth quarter of fiscal year 2000. Merrill Lynch called Homestore "a sector leader with continued strong growth."

210. On August 24, 2000, Robertson Stephens analyst Michael Graham published a report entitled "Homestore.com: We Believe Business is Going Great, and Getting Stronger with AOL Channel, We See Open-Ended Opportunity with Transaction Platform." Graham wrote that analysts at Robertson Stephens believed that "business is tracking ahead of expectations with catalysts in the next few months." Graham reported that Robertson Stephens "continue[d] to believe our estimates are conservative." In light of this enthusiastic endorsement Robertson Stephens increased third quarter revenues 6% to $53.0 million and indicated that "revenue upside could drive [Homestore stock] to profitability earlier than previously expected." The report indicated that there were a number of business catalysts approaching that would likely lead to additional profits for Homestore:

a. An increase in visits to Homestore's site to over 4 million unique users.

b. The expected launch of Homestore's home channel on AOL in September (the report indicated that the launch of the AOL home channel would likely double the traffic across the Homestore network).

c. Homestore's Realtors Electronic Transaction Platform, allowing the entire home buying process to occur over the Internet, "represent[ed] an open-ended opportunity targeting $100b in fees generated by home sales."

Given these developments Graham concluded that:

> The stock is beginning to recover following market and lock-up related weakness. With impending profitability and revenue multiple substantially lower than comparable companies, we recommend buying [Homestore stock] ahead of what we view as impending catalysts.

211. On September 14, 2000, Merrill Lynch analysts Blodget and Campbell added their endorsement to Homestore's acquisition of The Hessel Group and stated that they "continue[d] to believe that the company is on track to

meet or beat our 3Q estimates of $58mm in revenue and an adjusted EPS loss of $0.01." Merrill Lynch reiterated their Buy rating for Homestore's stock.

212. On October 4, 2000, Homestore announced the launch of its content on AOL's House & Home channel, giving AOL members direct access to Homestore's products and services.

213. On October 5, 2000, Merrill Lynch analysts Blodget and Campbell reported that they expected Homestore's third quarter results to "easily exceed our estimates." In addition, Merrill Lynch stated that they "believe the fundamentals remain strong, and maintain [their] buy rating." The report stated that Merrill Lynch's revenue estimate was "very conservative," that revenues could be seen as high as $63 million, and revenue per average subscriber "would be up 5% to $258 from $245." Merrill Lynch stuck to its expected EPS net loss forecast and stated that they expected Homestore to post a $0.01 adjusted EPS profit in the fourth quarter.

214. Beating all analyst expectations, Homestore announced, on October 19, 2000, that it had achieved net profitability ahead of schedule during the third quarter. This was a turning point for the company, since few Internet companies had achieved profitability. Indeed, even in non-Internet companies, becoming profitable was considered a pivotal event. In addition, Homestore announced that its net revenues exceeded expectations, netting more than $370 million. The press release, entitled: "Homestore.com, Inc. Reports Net Income Cash Profitability," announced Homestore's supposed "continued growth" and first-time "profitability." In pertinent part, Homestore stated:

> Homestore.com, Inc. joined the ranks of the small group of cashflow-positive publically traded dot-companies in the third quarter, achieving net income cash profitability of $554,000 for the period. The company today reported financial results for the quarter ended September 30, 2000, with continued growth in revenues, professional subscribers and unique visitors to its online home and real estate network, and over $370 million in cash on its balance sheet.
>
> "This quarter we joined an elite group of Internet companies that have achieved cash profitability," said Stuart Wolff, Homestore.com's chairman

> and chief executive officer, "and to accomplish this with such continued strong top-line growth, not only demonstrates the strength of our financial model, but also highlights the power of our strategic positioning and the continued execution of our management team."
>
> "The tremendous value of a central, online home and real estate marketplace is becoming apparent to more consumers and real estate professionals every quarter," Wolff added. "Our network has aggregated the largest audience of consumers and home professionals on the Internet today which serves as a powerful platform to further extend our subscription, advertising and transaction services and products," said Wolff.
>
> The company said revenues for the third quarter increased to $62.2 million, a 201% increase over pro forma revenues of $20.7 million for the third quarter of 1999 and a 24% increase over revenues of $50.2 million of the second quarter of 2000. The company's gross profit margin improved to 74.0% for the quarter as compared to 69.3%, on a pro forma basis, for the third quarter of 1999 and 73.5% for the second quarter of 2000. Pro forma net income for the quarter was $544,000, or $0.01 per share. That compares to a pro forma net loss of $16.8 million, or $0.25 per share, for the second quarter of 2000.
>
> On a GAAP basis, the company's revenues for the quarter were $62.2 million, compared to $18.6 million for the third quarter of 1999 and $50.2 million for the second quarter of 2000. The net loss for the quarter was $27.1 million, or $0.33 per share, compared to a net loss of $34.2 million, or $0.65 per share, for the third quarter of 1999, and $24.7 million, or $0.31 per share, for the second quarter of 2000.
>
> Increased revenue from both professional subscriptions and advertising drove overall revenue growth for the third quarter of 2000 over the second quarter of 2000. The growth in revenue from professional subscriptions was due to an increase in the number of professionals on the Homestore.com™ family of web sites, as well as an increase in the average price per subscription. Professional subscriptions rose approximately 131,000 at September 30, 2000, representing increases of 54% and 7% compared to totals at September 30, 1999 and June 30, 2000, respectively. Renewals also contributed to the increase in professional subscriptions with the renewal rate remaining consistent at approximately 70%. Growth in advertising revenue was primarily driven by an expansion in sponsorships and strategic alliances during the quarter.

215. Market analysts took quick notice of Homestore's reported success. On October 19, 2000, Bloomberg News reported on Homestore's press release, stating that Homestore's "revenue more than tripled in the third quarter because of more subscriptions **and advertising**." (Emphasis added). According to the article, Wolff attributed Homestore's success to "a combination of top-line growth together with bottom line operating leverage."

216. On October 20, 2000, Merrill Lynch analysts Blodget and Campbell maintained their "Buy" rating for Homestore's stock. Blodget and Campbell raised revenue predictions for Homestore for 2000 to $219 million from $210 million and 2001 estimates to $329 million from $320 million. Expected per share losses were reduced from $0.16 to $0.13 and 2001 estimated profit per share was raised from $0.35 to $0.37. The report indicated that there was "still significant upside in the new [estimates]." Regarding the company's future outlook, the report stated:

> While valuation, volatility, and weakness in technology stocks continue to be risks, we believe [Homestore stock] will perform well from this level for the next year or two. The company has clearly demonstrated its leadership in the category, the leverage of the model, continued strong sequential revenue growth, and management's ability to execute above expectations.

217. Later that same day, Merrill Lynch analysts Blodget and Campbell reported that Homestore's **"[a]d revenue grew 32% seq. to $29.2 mm, well ahead of our $25.5mm estimate, especially good news in the current environment."** (Emphasis added).

218. On November 9, 2000, Merrill Lynch analysts Blodget and Campbell reported on Homestore's "Impressive Analyst Day," stating:

> Homestore [would] be one of the Internet success stories over the next few years, and has the opportunity, leadership, technology and industry support to transform - and be at the center of - the home buying transaction.

Blodget and Campbell reported that Homestore defined its potential market as about $145 billion and that Homestore had only tapped into 10% of that market to date.

219. On January 11, 2001, Homestore issued a press release stating that its shareholders, in conjunction with the company's proposed acquisition of Move.com, had approved the issuance of approximately 26.3 million shares of common stock in the company. Homestore announced that the acquisition was

expected to close as soon as regulatory hurdles could be overcome. In the press release, Wolff stated:

> We are eager to get to work to further expand the most vibrant and comprehensive online home and real estate marketplace possible for the benefit of both consumers and professionals. We appreciate our shareholders' confidence and are looking forward to continued momentum.

The acquisition of Move.com was touted by Homestore as providing "a variety of synergistic opportunities resulting from the merged assets, as well as increasing financial benefits from the economies of scale the transaction will make possible."

220. On January 16, 2001, The *East Bay Business Times* published an article entitled, " Homestore buys IPIX assets." The same day, Homestore issued a press release entitled, "Homestore.com, Inc. Acquires Key Assets from iPix For Residential Real Estate Virtual Tours." The acquisition included the license to sell iPIX's Virtual Tour Technology and existing iPIX sales contracts. The purchase price was reported as $12 million in cash.

221. On January 25, 2001, Homestore issued a press release announcing Homestore's fourth quarter results. Wolff described the fourth quarter as "another quarter of strong revenue growth and cash profitability at Homestore.com." The company's reported net income for the fourth quarter of $3.3 million, or $0.04 per share, far exceeded all analysts' estimates and was a 400% increase in income per share over the $0.01 income per share for the third quarter of 2000.

222. On January 25, 2001, Homestore issued a press release entitled, "Homestore.com, Inc. Reports 27% Sequential Revenue Growth and Cash EPS of $0.04 for Fourth Quarter of 2000," announcing Homestore's alleged "second quarter of cash profitability." In pertinent part, Homestore stated:

> Homestore.com, Inc., the leading supplier of online media and technology to the home and real estate industry, today reported revenue of $79.0 million and net income, excluding certain non-cash items, of $3.3 million, or $0.04 per share, for the fourth quarter of 2000, the company's second consecutive quarter of cash profitability. Homestore.com ended its first full year as a publically traded company with 213% year-over-year growth in pro forma revenues, substantial increases in professional subscribers and unique

visitors to its online network, and more than $345 million in cash on its balance sheet.

"It is a pleasure to report another quarter of strong revenue growth and cash profitability at Homestore.com," said Stuart Wolff, the company's chairman and chief executive officer. "We have accomplished a great deal in the past 12 months, including the announcement of two exciting transaction platforms, the ongoing build-out of our ASP strategies and long-term agreement with AOL that gives tremendous exposure to our consumer content. All of this is a great tribute to the hard work and execution of the entire Homestore.com team as we look forward to another strong year of growth in 2001," he added.

The company said revenues for the fourth quarter increased to $79.0 million, up 182% from pro forma revenues of $28.0 million for the fourth quarter of 1999, and up 27% from revenues of $62.2 million for the third quarter of 2000. The company's gross profit margin was 73% in fourth quarter compared to a pro forma gross profit margin of 71% in the fourth quarter of 1999, and 74% in the third quarter of 2000. Pro forma net income for the fourth quarter was $3.3 million, or $0.04 per share. That compares to pro forma net loss of $16.2 million, or $0.23 per share, for the fourth quarter of 1999 and pro forma net income of $554,000 or $0.01 per share, for third quarter of 2000.

Subscriptions generated approximately 52% of total revenues in the quarter. The improvement was due to an increase in the number of professionals on the Homestore.com™ family of Web sites as well as an increase in the average revenue per subscription, which was primarily due to increased sales of ASP products, most notably Top Presenter 2. The number of professional subscriptions rose to approximately 145,000 at December 31, 2000, an 11% increase from the total at September 30, 2000. Renewals also contributed to the increase in professional subscriptions with the renewal rate consistent with prior quarters at approximately 70%.

Advertising produced approximately 48% of total revenue in the quarter. Growth in advertising revenue was primarily driven by an increase in advertising and sponsorship deals during the quarter, including Bank of America, Budget Group, and Kodak. Also contributing to the increase in advertising revenue was the company's expanded relationship with America Online, in which AOL sold advertising on the company's behalf.

The average monthly number of unique users visiting the Homestore.com network rose to approximately 4.3 million, up 102% from the fourth quarter of 1999 and up 3% from the third quarter of 2000. Each unique user spent an average of 19.7 minutes per month on the network, up 11% from the fourth quarter of 1999, and down 13% from the third quarter of 2000. The decreases in average minutes per visit and page views from the third quarter of 2000 were consistent with the seasonally slower fourth quarter. One billion homes were viewed on the Homestore.com network during the period. The cumulative number of homes viewed since the company's inception is now approximately 8.1 billion. (Emphasis added).

223. The market reacted positively to this news. When trading resumed on January 26, 2001, the day after the dissemination of the above press release, the price of Homestore common stock rose $3.1875, or 11%.

224. In response, Salomon Smith Barney ("Salomon") analyst Tim Albright raised Salomon's earnings estimates. Salomon described Homestore's fourth quarter as "extremely strong" and stated that "this is a strong story that keeps getting stronger." Salomon noted that the reported $79.0 million in revenues (versus their estimate of $68 million) was up 27% and operating profit of 4% exceeded their estimate of 1%. Salomon reiterated its "2S Outperform rating and $36 target price." The report ebulliently stated that "[t]his is an extremely strong Internet story." Advertising revenue was expected to exceed Salomon's estimate of $32.5 million, Homestore reported advertising revenue or $37.5 million. This rise of $5 million was attributed to "an expansion in sponsorships and strategic alliances during the quarter." Homestore's management reportedly boasted that "international expansion opportunities" would provide "a source of revenue upside."

225. In its January 26, 2001 report entitled, "Fulfilling the Promise of the Internet," Salomon stated:

> Homestore represents the original vision of an Internet company fulfilled. This is a high margin, fixed-cost business model that has seized an early leadership position, and extended it into complete dominance over a sizeable category that is perfectly suited for the medium. The result is a rapidly growing, industry-transforming, profitable business. Our $36 price target, which is likely conservative, is a PEG EPS multiple on out 2001 estimate of $0.38. We believe that both numbers have room to rise.

226. That same day, Merrill Lynch analysts Blodget and Campbell reported that they were "raising estimates again (!)" in light of Homestore's first quarter of reported profitability. Blodget and Campbell described Homestore's reported revenues as "a very strong quarter in a weak market." Merrill Lynch raised 2001 revenue estimates "to $350 million from $329mm and raised expected

earnings per share "to $0.40 from $0.37." Merrill Lynch's 2002 estimates for revenue went to $468mm in revenue and $0.72 earnings per share.

227. The Merrill Lynch report touted "amazing 30%" sequential growth in advertising up to "$37.9mm (in a flat ad market)." The report attributed growth in advertising revenue to "a fortune 500 advertiser base, increased inventory from the AOL deal, and an excellent user demographic." According to the report, professional subscriber revenue "grew 25%" sequentially to $41.1 million, driven by 1) 14,000 new subscribers, well ahead of our 8,000 estimate, and 2) a 14% sequential increase in revenue per average subscriber.

228. On January 26, 2001, *The Industry Standard* published a report entitled, "Homestore Earns Big in a Down Season," in which Stuart Wolff explained why Homestore was doing so well, specifically in ad revenue, while other Internet companies are missing earnings or filing for Chapter 11 bankruptcy protection. Wolff stated, "I think the fourth quarter says a lot about us as a company. In a difficult quarter we actually accelerated our revenue growth. There are probably only five other tech companies that were able to do that." The article touts Homestore's unique ability to increase its advertising revenue with contract wins from Bank of America, Kodak and Budget Group in an otherwise poorly performing market. The author also noted that Homestore's subscription revenue, comprising more than half of its total revenue, enjoys a 70% renewal rate.

229. On February 5, 2001, Merrill Lynch analysts Blodget and Campbell reported that they were raising 2001 and 2002 revenue estimates for the second time within a two week period. The report stated:

> Homestore reported blow-out 4Q numbers two weeks ago. At the time we raised estimates and said we believed our numbers were still conservative. After working through the numbers in more detail, we are further increasing estimates.

Blodget and Campbell increased the 2001 revenue estimate "from $350mm to $355mm" and the earnings per share estimate "from $0.40 to $0.43 (untaxed)." The 2002 revenue estimate was increased "from $467mm to $477mm" and earnings per share "from $0.72 to $0.77 (untaxed)." The report stated that there was still upside to the stock's current price of $29 and predicted that the 2001 earnings per share could climb as high as "$0.50-$0.75 (untaxed)" and "$1.00 or more in 2002." The report maintained Merrill Lynch's "Buy" rating for the stock.

230. On February 20, 2001, Homestore issued a press release and announcing it had completed its acquisition of Move.com from Cendant Corporation. The acquisition was vaunted as a source of additional "revenue streams and cost synergies."

231. On February, 20, 2001, Merrill Lynch published a bulletin supporting the Move.com acquisition and touting Homestore's dominance in the Internet real estate business. Merrill Lynch gave Homestore a glowing endorsement regarding Homestore's expected earnings and future earnings potential. Merrill Lynch's report stated in pertinent part:

> We regard Microsoft's retreat from the mortgage technology business as more of a psychological boost than a real change in the competitive landscape (we believe Homestore had a significant lead). Since one persistent investor concern has been "the Microsoft threat," however, we view this as positive for the stock.
>
> Our 2001 stand alone company estimates are revenue of $355 million (+55%) and EPS of $0.43 (untaxed). 2002E is revenue of $477 million (+35%) and EPS of $0.77 (untaxed).
>
> At $34, [Homestore stock] is trading at about 77X 2001E EPS and 43X 2002E. We expect long-term EPS growth of 50%-75%, so this is still a PEG ratio of less than 1.0X. Furthermore, we believe there is still upside. We believe the company could earn 2001E EPS of $0.50-$0.75 including move.com and $1.00 or more in 2002. We reiterate our Buy rating.

The Move.com acquisition was interpreted by Merrill Lynch as a positive for Homestore and its stock because it was viewed as: "1) accretive, 2) eliminates major competitor, 3) gains access to 25% of industry brokers and transactions, 4) improves real listings business." Merrill Lynch likened Homestore to the little engine that could and stated that "[a]s the competition falls to the wayside, Homestore continues to plod along, securing its spot as the dominant online real estate player."

232. According to a Homestore report, the company believed that the acquisition would raise 2001 revenue to $443.0 million from $349.8 million and earnings per share to $0.44 from $0.38. They also stated that 2002 revenue would increase to $600.3 million from $472.3 million, and earnings per share would accrue to $0.84 from $0.73. A section of the report entitled, "Investment Thesis and Valuation" boasted about the value added to Homestore stock by the Move.com acquisition:

> Homestore represents the original vision of an Internet company fulfilled. This is a high margin, fixed-cost business model that has seized an early leadership position, and extended it to complete dominance over a sizeable category that is perfectly suited for the medium. The result is a rapidly growing, industry-transforming, profitable business. Raising stock price target to $42, on growth-based EPS multiple of 50x or 2002 estimate of $0.84. We believe that both numbers have room to rise. Our ratings improvement from 2S (Speculative) to 2H (High Risk), reflects an improvement in the risk profile with respect to the original DOJ investigation. The end result of this acquisition is that Homestore emerges with a firmer ownership on a very attractive market.

233. On February 21, 2001, Merrill Lynch analysts Blodget and Campbell again raised revenue estimates in light of Homestore's announced acquisition of Cendant's Move.com web site. Blodget and Campbell raised 2001 revenue estimates "to $453mm from $355mm" and earnings per share (untaxed) "to $0.46 from $0.43." The report indicated that these estimates were "slightly ahead of management's forecast."

234. On March 14, 2001, Homestore issued a press release entitled, "Kodak, Homestore.com, Inc.- Operator of Realtor.com - To Provide Real Estate Professionals With High Quality, Internet Imaging Services." This release announced a three-year agreement intended to accelerate the growth and use of digital imaging by real estate professionals on the Internet. Under this agreement Kodak would purchase targeted sponsorship impressions across the Homestore family of web sites.

235. On March 27, 2001, WR Hambrecht + Co announced that it would start to cover Homestore's stock performance. WR Hambrecht + Co analyst Derek Brown cited "Homestore.com's category leadership, profitable business model, and attractive valuation" as reasons for WR Hambrecht + Co's "Buy" rating and target price of $40 for Homestore's stock. Brown wrote:

> In our opinion, Homestore.com is rapidly emerging as a key component of the 21st century residential real estate industry. The company's market-leading Web portal is a valuable consumer resource and an efficient and cost effective marketing channel for real estate professionals, service providers, and manufacturers. When coupled with its rapidly expanding suite of professional technology solutions, Homestore.com has the appearance of an 'operating system' for the home- and real-estate-related industries.

236. On March 28, 2001, Prudential Securities analyst, Mark J. Rowen, in an article entitled "Homestore.com is Building a Fortress–We are initiating Coverage With a Strong Buy Rating," reported that Homestore's partnerships with key industry players: "the National Association of Realtors; The National Association of Home Builders, a majority of multiple listing services ("MLS"), and a number of key brokerage firms," would "help Homestore build a fortress around its business, and help it sustain a competitive advantage." Rowen wrote that "patient investors will be rewarded" for buying Homestore's stock as "operating margins and EPS increase rapidly over the next 12-24 months." Homestore's stock was given a 12-month price target of $32. The report described Homestore's revenue sources as "industry subscribers (for example, real estate agents, brokers, and homebuilders), **advertisers hoping to reach a highly targeted audience**, transaction fees, and the licensing of its online software platform." (Emphasis added). The article posited that because users can access more listings on the Homestore site they will be more likely go there to look for homes and as "a greater number of buyers attract a greater number of sellers, while a wide choice of home listings from the sellers attract additional buyers." Rowen concluded that "Homestore may have formed the basis for a sustainable

competitive advantage with its MLS agreements." In addition to lauding Homestore's business model and its long term growth potential, Rowen's article was very positive about growth and increases in revenues from subscriber fees.

237. Rowen's article made further positive statements about Homestore's business potential: (i) the company was expected to improve its margin, while rapid revenue growth would continue; (ii) the site is well organized to provide a full range of real estate services; (iii) the company has the opportunity to expand revenue significantly in the long-term; (iv) Homestore is developing Internet based application platforms with equity partners NAR, FannieMae, GMAC, Verisign, and ReformsNet and with five or the largest relocation services companies in the United States that will have revenue impact in the near future; (v) Homestore is expanding into the international market; (vi) Homestore is a more effective platform for home searches than the competing Internet Realtors because it offers more listings on its site than other sites, this advantage is a result of its relationship to NAR and various MLSs across the country; and (vii) increased subscription fees and higher-margin advertising and the company's ability to sell more products to subscribers will lead to improved margins. The article indicated that **Homestore's "advertising revenue per 1,000 page views was $68.98 in the fourth quarter, unusually high for Internet advertising, owing to sponsorship agreements not dependant on page views."** (Emphasis added).

238. On April 2, 2001 Homestore filed its annual results for the year 2000 in its Form 10-K, representing that the financial statements were prepared in accordance with GAAP, and had been audited in conformance with GAAS. Homestore's 2000 Form 10-K reiterated the financial results set forth in the January 25, 2001 press release. However, as alleged below, these results were materially false and misleading because Homestore overstated its on-line advertising revenues by $36.4 million. Certain advertising transactions should not

have been recognized revenue because they were barter transactions, the buying of revenue or "round tripping."

239. On April 3, 2001, Salomon analyst Tim Albright wrote an article entitled, "HOMS: Strong Company, Complex Story; Discipline Required," stating that revenue and EPS as of March 2001 "have much upside potential, due to guidance coming out of the Cendant deal." Albright noted Homestore's significant "**reliance on advertising**." (Emphasis added). Albright indicated that Salomon had "110% confidence in Homestore's ability to make its Q1 numbers" and stated that they believed that Homestore is a "powerful, profitable company." Salomon recommended that investors buy Homestore stock when it dipped under $20 per share.

240. On April 10, 2001, Salomon analyst Albright, in an article entitled "Consumer e-Commerce Survivors Should Meet or Beat Q1. Online Consumer Lives," boasted that its group of "consumer e-commerce survivors... shoul0d meet or beat Q1 estimates" and that they had "upside against published estimates." Salomon predicted that its estimate that Homestore would make revenues of $107 million had "$8 million to $13 million in revenue upside and $0.02 to $0.03 in EPS upside."

241. On April 10, 2001, Homestore issued a press release entitled, "Bank of America and Homestore.com, Inc. Announce Multi-Year Strategic Agreement," announcing the launch of a new online homeowner service.

242. On April 25, 2001 Homestore issued a press release entitled, "Homestore.com, Inc. Reports Strong and Steady 1st Quarter Growth; Cash Profitability, Strong Revenue Growth Market Record Performance." In pertinent part, Homestore stated:

> Homestore.com, Inc., the leading supplier of online media and technology to the home and real estate industry, today reported pro forma revenue of $118.4 million and pro forma net income, excluding the effects of certain non-cash items, move.com acquisition-related charges and write-down of certain investments, of $4.0 million, or $0.04 per share, for the first quarter of 2001, the company's third consecutive quarter of cash profitability.

> "I'm extremely proud of the Homestore.com team for posting a very strong quarter in a very difficult market," said Stuart Wolff, chairman and chief executive officer. "I'm also very pleased with the speed at which we have integrated the move.com acquisition while continuing our track record of strong operational performance."
>
> The company said pro forma revenues for the first quarter increased to $118.4 million, up 105 percent from pro forma revenues of $57.6 million for the first quarter 2000, and up 11 percent from pro forma revenues of $106.4 million for the fourth quarter of 2000. The company's pro forma gross profit margin of 64.7 percent for the first quarter of 2000, and 71.7 percent, on a pro forma basis, for the fourth quarter of 2000. Pro forma net income for the first quarter was $4.0 million, or $0.04 per share. That compares to pro forma net loss of $33.7 million, or $0.35 per share, for the first quarter of 2000 and pro forma net loss of $14.6 million, or $0.14 per share, for the fourth quarter of 2000.

243. Following the April 25, 2001 press release, the price of Homestore common stock rose $5.27, or 18% to $34 per share.

244. On April 26, 2001, Robertson Stephens analysts Jay P. Leupp and Paul R. Penney adjusted their estimates for 2001 and 2002 in light of Homestore's strong first quarter results. The 2001 estimates for revenue and earnings per share were adjusted upward from $442.9 million and $0.44 respectively to 502.6 million in revenue and $0.54 in earnings per share for 2001. The 2002 estimates for revenue and earnings per share were adjusted from $611.8 million and $0.84 to $665.0 million in revenue for 2002 and $0.90 earnings share. The report reiterated Robertson Stephens "Buy" rating for Homestore stock.

245. On April 26, 2001, Salomon analysts Albright and Bruce van Raalte, touted Homestore's "terrific" first quarter revenues. The report noted the $75.6 million in subscription revenue, up 18% over the fourth quarter of 2000. In a section of the report entitled "Strong Story, Great Visibility," Salomon raised its revenue estimates and earnings per share estimates for 2001 and 2002. Revenues for 2001 were raised from $443 million to $515 million for 2001 and from $600 million to $680 million for 2002. Earnings per share estimates were also raised for 2001, from $0.44 to $0.53 and in 2002 from $0.84 to $0.90. The report strongly endorsed Homestore's promising future again stating that "Homestore represents the original vision of an Internet company fulfilled." Salomon gave the

stock an "Outperform, High Risk" rating and described Homestore as a "terrific franchise."

246. On April 26, 2001, Merrill Lynch analysts Blodget and Campbell, in a report entitled "Another Strong Quarter; Raising Estimates Again," raised 2001 estimates "from $450mm to $502mm" and raised earnings per share estimates "from $0.85 to $0.95." The report boasted: "This is the third estimate increase in three months–impressive, considering the environment." This increase was "based on higher sales, improved operating margin and slightly lower interest income." Blodget and Campbell indicated that advertising revenue was surprisingly ahead of their forecast: **"Ad revenues were down 2% seq. at $42.6mm but ahead of our est. of $41.7mm, an impressive feat in a market we believe declined 25% during the quarter."** (Emphasis added).

247. On May 1, 2001, ABN AMRO analysts Arthur Newman and David J. Kolb, in an article entitled "Home Is Where the Profits Are: [Homestore stock] Exceeds Estimates," reported that Homestore's first quarter financials "were well ahead of our and consensus estimates." In addition, ABN AMRO analysts noted "the strength [of Homestore's] business model, even in tough economic times, and impressively slashed costs from its recent acquisition of Move.com." Homestore's "revenue mix" was described as a healthy combination of subscriptions and advertising revenue:

> About 65% of estimated 2001 revenue comes from selling subscription services, such as Web sites linked to real estate listings and integrated contract-management software, to real estate firms and professionals. Online **advertising represents most of the remaining revenue**, although transaction revenue should eventually become a material part of the business model. (Emphasis added).

Advertising revenue for the company was reported as surprisingly consistent, given that other major Internet stocks' advertising revenue had declined during the same period:

> Advertising revenue was $42.6 million, representing 36% of 1Q01 revenue, vs. 41% in 4Q00, and 36% in 1Q00, which we consider

> quite an accomplishment, given the generally poor state of online advertising. By comparison, Yahoo! reported a 50% decrease in domestic online advertising revenue over the same period. We believe [Homestore stock] is successful because it can deliver a highly targeted audience poised to make significant financial outalays, financially stable nondot-coms. The company estimates that less than 6% of its advertising revenue (or less than 2% of total revenue) is derived from dot-coms.

ABN AMRO analysts' conclusions about Homestore were particularly enthusiastic:

> Homestore.com reported exceptionally strong 1Q01, reporting figures that were well above expectations. We believe this would be a strong performance in any quarter, but it is particularly notable given the widespread poor performance among e-commerce companies and other dot-coms. On April 26, we raised our 2001 [sic] and 2001 forecasts for revenue and profits, lately a rare event in the Internet or technology sector.
>
> In our view, [Homestore's stock] is not a typical Internet company. In our analysis, it dominates the market for online media and software for the real estate industry, has deep industry partnerships, has a healthy revenue mix with a strong recurring component, has broad online distribution with improving online metrics, is profitable, and has no material competitors. We believe the 1Q01 performance confirms the validity of the company's business model. With its attractive valuation, [Homestore stock] remains the only Buy-rated stock in our consumer Internet universe.

248. On May 10, 2001, in response to "questions about Homestore's liberal use of equity to pay for operating expenses, as well as the validity of excluding these expenses from pro forma EPS," Merrill Lynch analysts Blodget, McCabe and Gernitis, revised Merrill Lynch's financial estimates in light of Homestore's use of equity, mainly Homestore stock, to pay for various operating expenses while excluding those payments from the company's valuation calculations. The report indicated that unlike comparable Internet and technology companies, such as Yahoo! eBay or AOL, Homestore's reported pro forma results "exclude some non-cash, stock based expenses that we regard as operating expenses." Therefore, Merrill Lynch opined that "the *pro forma* results are meaningful as a measure of current *cash* earnings, but not operating earnings. [Other Internet stocks'] pro forma results, in contrast, are closer to true operating

earnings." However, Homestore's pro forma results were cited as providing "a good view of the company's cash consumption/generation" and therefore were useful in forecasting Homestore's cash flow. Homestore's pro forma earnings per share were much higher than other Internet and technology companies. Merrill Lynch analysts attributed this difference as follows:

> Homestore pays for many of its content, distribution, and marketing expenses using stock instead of cash (which is a legitimate, defendable, and even shrewd decision for a young company with a strong currency, in that it conserves cash). . . The equity cost to Homestore of the AOL deal and other deals is included in the "stock-based charges" line on the income statement. This line is excluded from pro forma results (under the theory that it is a non-cash expense).

249. Merrill Lynch continued to report about the company's "upside" and stated that:

> Homestore has consistently beaten estimates in the past. Over the last four quarters, the company has bested our quarterly revenue estimates by as much as 25% and no less than 7%. Similarly, our EPS estimates have been beaten by as much as $0.06 and no less than $0.02. Although we're at the high-end of the street for 2001 and 2002 (as we have generally been in the past), we still believe upside is likely. To avoid assessing valuation on EPS estimates that are too low, therefore, we believe investors should assume some upside to the company's stated targets (and consensus estimates).

250. On May 15, 2001, Homestore filed its Form 10-Q, reporting quarterly financial results for Q1 2001. Homestore represented in its 10-Q that the company's financial results were presented in accordance with GAAP. However, as alleged below, the statements in both the April 25, 2001 press release and the Form 10-Q were materially false and misleading because Homestore overstated its on-line advertising revenue. Certain advertising transactions should not have resulted in revenue recognition because they were barter transactions, the buying of revenue or "round tripping."

251. On May 16, 2001, Robertson Stephens analysts Leupp and Penney, in an article entitled "Urge Investors to Take Advantage of Current Price Weakness, as We Believe the Company's Dominant Position in the Real Estate Media &

Technology Sector Will Overshadow Near-Term Valuation Debate; Reiterate Buy Rating," defended Homestore in light of the report written by Merrill Lynch analysts questioning Homestore's frequent use of stocks instead of cash to pay for operating expenses. The report defended Homestore stating that paying operating expenses with stock was disclosed fully and was "more than justifiable, given [Homestore]'s industry dominance and adequate cash reserves." Robertson Stephens analysts cited Homestore's business growth (acquisitions), growth in professional services (new subscriptions), and growing site usage as factors validating "the functionality of Homestore.com's network of sites." Homestore stock was rated "Buy" and the report forecast that "the company's recent acquisitions and partnerships . . . further enhance [Homestore]'s dominance as the real estate platform of choice for both real estate consumers and professionals."

252. On June 26, 2001, Merrill Lynch analysts Blodget and Campbell raised estimates for Homestore's revenue once again, and the report indicated that there was "little that would change the company's habit of delivering modest upside to its targets, and our model suggests there is upside to these targets. We are therefore raising our estimates." The report forecasted that "[r]evenue increase [would be] driven by higher professional subscription revenue . . . as Homestore recognizes a full period of revenue from Cendant related subs." Blodget and Campbell concluded:

> In the current environment, making our projection of flat sequential advertising revenue for Q2-Q4 will not be a lay up, but, in our view, it is achievable for three reasons: 1) the AOL deal has nearly doubled inventory, 2) the audience is highly targeted and with the Move.com acquisition, Homestore is the only game in the real-estate town, and 3) total dotcom exposure is low–under 6% of advertising revenue.

253. In another report dated June 26, 2001, Merrill Lynch analysts Blodget and Campbell reported that, with regard to fiscal year 2001 revenue, they expected Homestore's revenue to increase to $525 million and pro forma earnings per share

to be $0.56. These numbers were considerably higher than the industry consensus of "$500mm/$0.53", and Merrill Lynch maintained it "Buy" rating for the stock.

254. On July 25, 2001, Homestore issued a press release entitled, "Homestore.com, Inc. Reports Eighth Consecutive Quarter of Strong Results," claiming the Company had achieved "record" results and a third quarter of cash "profitability." Wolff boasted about the "continued strength in both major revenue streams: subscriptions and advertising." In pertinent part, Homestore stated:

> Homestore.com, Inc., the leading supplier of technology and online media to the home and real estate industry, today reported record revenue of $129.3 million and pro forma net income, excluding certain charges, of $14.5 million, or $0.13 per share, for the second quarter of 2001, the company's fourth consecutive quarter of increasing pro forma earning per share.
>
> "I am pleased to announce our eighth consecutive public quarter of strong top and bottom line results, particularly given the difficult market climate," said Stuart Wolff, Homestore's chairman and chief executive officer. "The strength of our quarter is testament to the speed with which we have integrated Move.com and the continued strength in both major revenue streams: subscriptions and advertising."
>
> The company said revenue for the second quarter reached a record $129.3 million, a 79 percent increase over pro forma revenue of $72.4 million for the second quarter of 2000. The company's gross profit margin was 74 percent for the second quarter compared to a pro forma gross profit margin of 71 percent for the second quarter of 2000. Pro forma net income for the second quarter was $14.5 million, or $0.29 per share for the second quarter of 2000.

255. On July 26, 2001, Merrill Lynch analysts Blodget and Campbell reported that they would raise estimates in light of Homestore's reportedly strong second quarter revenue reports. Blodget and Campbell wrote that "Q2 Revs and EPS were in line with our estimates (and well above consensus)." The report stated that second quarter revenue "was $129mm (+79%), driven (ironically) by strong advertising revenue. EPS was $0.13, driven by aggressive cost cutting after the move.com acquisition." Revenue estimates were increased "from $500mm to $530mm (+64% Y/Y) and pro forma EPS remains at $0.55. 2002E rev. goes from $650mm to $685mm (+29% Y/Y), and [pro forma] EPS from $1.00 to $1.10 (+100% Y/Y, above company target of $0.93)." In comparison, Homestore's

revenues on a "fully-taxed, operating basis," were estimated at "about $0.35 in 2002 and $0.70 in 2003."

256. On August 14, 2001 Homestore filed Form 10-Q, which repeated its 2Q 2001. Homestore represented that the company's financial results were presented in accordance with GAAP. However, as alleged below, the statements in both the July 25, 2001 press release and the Form 10-Q were materially false and misleading because Homestore overstated its on-line advertising revenue. Certain advertising transactions should not have resulted in revenue recognition because they were barter transactions, the buying of revenue or "round tripping."

257. In a report entitled "Home Alone: Beats Estimates," ABN AMRO analysts Arthur Newman, David J. Kolb and Suk Han announced that:

> Even in this challenging economic environment, [Homestore] continues to excel. We continue to see [Homestore stock] as a core and reasonably valued holding, and it remains the only Buy-rated stock in our universe.

ABN AMRO's report indicated that Homestore's second quarter reported earnings per share of $0.13 was "comfortably ahead" of their estimate of $0.11. In light of Homestore's reported earnings ABN AMRO raised their earnings per share estimates for 2001 to $0.55 from $0.51 and raised their revenue forecast to $523 and $680 for 2001 and 2002 respectively. The report highlighted the fact that The report compared Homestore's advertising revenue was $50.6 million or 39% of first quarter 2001 revenue, calling the reported growth in advertising revenue of 18.6% "quite an accomplishment, given the generally poor state of online advertising." The report compared Homestore's valuation at 46.7 times estimated 2001 earnings per share to eBay's current valuation of 128.4 times estimated 2001 earnings per share. Homestore's valuation was forecast to have "upside" for 2002 compared to ABN AMRO's estimates.

258. On August 6, 2001, Piper Jaffray analysts Safa Rashchy and Joshua S. Meyers reported that their brokerage house would initiate coverage of

Homestore stock, giving the stock a target value of $45 or 75 times estimated, fully taxed 2002 earnings per share. The analysts noted several indicators of the strength of Homestore's business: (i) the "nearly 8 million monthly unique visitors (nearly twice its nearest competitor) and the large number of real estate professionals who are members of Homestore's network; (ii) the migration of real estate professionals onto the Internet; and (iii) Homestore's diverse revenue sources; solid revenue from non-dot-coms and **solid revenue growth from advertising generally**." (Emphasis added). Growth catalysts listed were: "1) continued migration of real estate functions online; 2) up-selling, cross-selling, and increasing prices of subscription services; and 3) **continued strong advertising revenues**." (Emphasis added). The report noted a 60/40 ratio of subscription revenue to advertising revenue. The analysts Rashtchy and Meyers concluded:

> HomeStore has a highly profitable and sustainable business model in a growing market. Although execution and expansion of this model are not without risks, especially given various partnerships and arrangement [sic] the Company maintains. We believe Homestore will be able to sustain the expected growth rates in the next four to six quarters.

259. On August 13, 2002, Piper Jaffray analysts Rashtchy and Meyers touted Homestore's acquisition of iPlace.com as representing a possible third source of revenue, consumer subscriptions, to Homestore's existing revenue sources. The report stated that although the price of the acquisition could be described as "a little rich," Piper Jaffray "remain[ed] positive on the growth outlook of Homestore and maintain[ed their] "Buy rating."

260. On August 14, 2001, Homestore's Wolff announced "[c]onsumer home and real estate traffic continues to be a key driver of our revenue streams and we are extremely pleased that the Homestore Network of Web sites is now drawing nearly double the amount of individuals it did at this time last year."

261. On August 24, 2001, Salomon analysts Lanny Baker, Eileen Furukawa and Karin Brett, in an article entitled "HOMS: Survey Says Foundation

Laid, Homestore Hammering Away," announced the results of a telephone survey of "176 real estate professionals employed by Cendant franchises." This survey seems to have been performed "partially out of concern about [Homestore's chances of] renewing 180,000 subscriptions originated in a bulk purchase by Cendant." Salomon's survey found that there was "enthusiasm about the Internet" among those contacted in the survey and the survey found that people familiar with Homestore's product often used the site's services. However, surprisingly, "half of the iLEAD subscribers were unaware of the service that Cendant has subsidized on their behalf." Of those contacted, the survey found that many of the Cendant subscribers would likely not renew their subscriptions with Homestore. Hurdles to Homestore's continued growth identified by the report included: "moving beyond the overhang of the Cendant-user renewal process and weathering a softening online advertising market." Homestore's chances of overcoming these obstacles were endorsed by Salomon's analysts who stated:

> Homestore currently enjoys a healthy valuation based on EBITDA and pro forma earnings estimates, which estimates in themselves have been aided by the strong use by Homestore of equity in lieu of cash payments. All that being said, we strongly believe in the company's long-term prospects given the huge market opportunity ripe for the taking by Homestore.

262. On August 28, 2001, Homestore's share value sank by more than 12% and hit a 52-week low. Wolff told Bloomberg News that nothing had changed to cause this drop. Wolff stated, "All we've had is positive news, eight positive quarters."

263. On September 6, 2001, Homestore announced in a press release that it was "reaffirming revenue guidance of $134 million for the third quarter or 2001." The press release indicated that Homestore would maintain its pro forma earnings per share "guidance, excluding certain items, of $0.16."

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264. Later on September 6, 2001, Homestore issued a second press release, stating that it was "on target to meet or beat I-LEAD XL 2002 renewal targets" for the sales associates affiliated with Cendant's [real estate brokers]."

265. According to the *New York Times*, Homestore was also hyping its stock at trade conferences. "As recently as September 6, for example, Homestore executives took their show to investors at Salomon Smith Barney's 2001 Technology Conference in New York. They confirmed analysts' projections for a big earning pop in the third quarter and the full year, and, using a figure from a previous quarter, said the company held more than $325 million in cash. But this figure included $90 million that cannot be touched under the terms of a deal with AOL and $70 million earmarked for acquisition."

266. In preparation for its September 10, 2001 article entitled, "Accounting Issues Dog Homestore.com," the *Los Angeles Business Journal* attempted to obtain the facts about how Homestore was calculating its reported earnings, noting: "Depending on how you're counting, the second quarter results either generated a net income of $14.5 million, about 13 cents a share - or a net loss of $72 million, about 31 cents a share." The $72 million figure was derived using GAAP accounting principals, while the $14.5 million figure was calculated using pro forma earnings. The *Los Angeles Business Journal* reported: "Wolff would not address pro-forma numbers during the brief interview. Several hours later Gary Gerdeman, a spokesperson for the company, e-mailed a note to the *Business Journal* that said: 'I'm sorry to report that I can't make anyone else available for an interview on this matter, but I do appreciate your interest in Homestore.'" On August 19, 2001, Wolff did tell the *Los Angeles Times* that pro forma earnings are simply another tool investors can use to measure performance, and not a way to inflate results: "We don't tell investors what's important and what's not."

267. Other Defendants made similar comments about Homestore's pro forma policy. On August 9, 2001 *The Ventura County Star* reported that, "Joseph Shew, Senior Vice President and Chief Financial Officer of Homestore, declined to take sides on the valuation debate but defended his company's use of pro forma earnings." On June 4, 2001, Defendant Giesecke told the *Industry Standard* that, "most technology companies report pro-forma results. These were not just stock-for-revenues deals. We are creating partnerships here."

268. Analysts appeared to accept Defendants' repeated assurances. On September 10, 2001, *The Los Angeles Business Journal* reported that, "Henry Blodget of Merrill Lynch said that while using equity to pay for operating expenses like marketing is certainly appropriate, reporting as pro forma expenses makes it difficult to analyze the company's value. 'This is not a disclosure issue. It is, however, a valuation issue.'"

269. Following the events of September 11, 2001, Homestore company spokesperson, Gary Gerdemann shifted blame for Homestore's revenue shortfall on the events of that tragic day. "Once September 11 happened, we were completely unable to make sales calls or close any pending." Only five days prior to September 11, the company was still hyping their stock at the Salomon Smith Barney's 2001 Technology Conference in New York.

270. On October 3, 2001, Homestore shocked the market when it issued a press release and reported that it was reducing its projected revenue and earnings for the third quarter of 2001. Homestore projected that its third quarter revenue would only be between $118 and $144 million, which would result in a pro forma loss per share of between $0.01 and $0.06 per share.

271. On November 1, 2001, Homestore issued another press release entitled "Homestore Reports Third Quarter Results," predicting even worse revenues than previously announced:

> Homestore.com, Inc., the leading supplier of technology and online media to the home and real estate industry, today reported revenue of $11.61

> million and a pro forma net loss, excluding certain charges, of $6.9 million or $0.06 per share for the third quarter 2001.
>
> "In light of the changed business environment, we are taking the actions necessary to maintain our leadership position in the online real estate market," said Stuart Wolff, Homestore chairman and chief executive officer.

272. On November 14, 2001, Homestore filed its previously reported quarterly financial results for Q3 2001. Homestore represented that the company's financial results were presented in accordance with GAAP. However, the statements in both the November 1, 2001 press release and the Form 10-Q were materially false and misleading because Homestore overstated its on-line advertising revenue. Certain advertising transactions should have been itemized as barter transactions rather than revenue because they were related to purchases of goods and services from third parties.

E. <u>The Truth Is Revealed and Impact on Stock Price</u>

273. On December 21, 2001, Homestore announced that it would restate its financial results and report only $375-$425 million in revenue, down from $563 million. The drop was, in part, a result of the breakdown of the revenue sharing agreement between Homestore and AOL. Homestore's share price plummeted the following day down to $2.28 from $4.99 per share, a drop of more than 54%. Homestore failed to disclose that the reason for the drop Defendants' inflation of revenue figures for the previous quarters through improper "roundtrip" or "barter" transactions.

274. On November 11, 2001, the *New York Times* reported that, "Since its public debut two years ago, [Homestore] had never been willing to provide a breakdown of its ad revenues for anyone interested in seeing what portion came from sponsorships and how much came from spot ads." Mark Rowen, an analyst from Prudential Securities, stated that, "Homestore was particularly difficult to figure out. Even if you thought something wasn't right, it was hard to put your finger on it because of the lack of disclosure. But it seems almost unfathomable

that management of an online advertising business would not know that it was going to miss projections by 40 or 50 percent until the last week of the quarter."

275. On December 6, 2001, Homestore announced that its Chief Financial Officer, Shew, had resigned "for personal reasons." In response to news of this resignation, Homestore's stock price fell another 20%.

276. On December 6, 2001, Merrill Lynch analysts Blodget, McCabe and Gernitis reported that the resignation of Shew "could create some uncertainty, which will likely be viewed as a negative." As a result of this news Merrill Lynch announced that it was placing Homestore's stock under review.

277. By restating its financial statements, Homestore has admitted that each document publishing the original financial results contained untrue statements of material fact. Thus, the restatement is an admission that each of the press releases and the quarterly reports filed with the SEC for Fiscal Year 2000 and the periods ended March 31, June 20 and September 31, 2001, contained untrue statements of material fact.

278. The public dissemination of this materially false and misleading financial information caused Homestore's shares to trade at artificially inflated prices throughout the Class Period. As the false financial results were reported throughout Fiscal 2000, Homestore's stock price increased. As the fraud was revealed and assimilated by the marketplace, the price of Homestore's common stock declined to a low of $2.28 per share on November 2, 2001.

279. Two weeks later, Homestore begrudgingly began to reveal that its accounting, and the company's prior financial results, were inaccurate. In its December 21, 2001 press release entitled, "Homestore Announces Accounting Inquiry," Homestore stated in pertinent part:

> Homestore.com, Inc. announced today that the Audit Committee of its Board of Directors is conducting an inquiry of certain of the company's accounting practices. The Audit Committee has retained independent counsel and independent accountants to assist in connection with the inquiry. While it is not yet possible to predict the results of the inquiry, based on the inquiry to date, **the company has determined that it will**

> **restate certain of its financial statements**. The extent of the restatement and the periods it will cover has not yet been determined. (Emphasis added).

280. In response, the NASDAQ stock market revoked Homestore's trading status on Friday, December 21, 2001. As of that date, Homestore's price per share was $3.60, down from a high during the Class Period of $122.25 on January 25, 2000. On December 24, 2001 NASDAQ announced that the halt on Homestore trading would continue until NASDAQ obtained "additional information [it had] requested" from Homestore.

281. On December 26, 2001, Piper Jaffray analysts Rashtchy and Meyers reported that "while the reemerged company may be a good acquisition target, we will continue to avoid the stock until the full inquiry is out." Piper Jaffray maintained their "Outperform" rating of the stock.

282. On January 2, 2002, Homestore issued a press release providing further information regarding its December 21, 2001 restatement. The press release entitled "Homestore Provides Additional Accounting Inquiry Information," stated in pertinent part:

> Homestore.com, Inc. (Nasdaq: HOMS) today released additional information about the inquiry by the Audit Committee of its Board of Directors into certain of the company's accounting practices, that the company announced in its press release on December 21, 2001. The Audit Committee, with the assistance of independent legal counsel and independent accountants, has continued to conduct a thorough inquiry into the company's accounting practices. The inquiry is not yet complete and, while it is not yet possible to predict the ultimate results of the inquiry, the company has made a preliminary determination that it will restate certain of its financial statements.
>
> **Based on the preliminary results of the inquiry to date, the company has determined that it overstated its on-line advertising revenues in the first three quarters of 2001 by between $54 million and $95 million in connection with certain advertising transactions that should have been accounted for as barter transactions because they were related to purchases by the company of goods and service from third parties.** When the company completes its analysis of the overstatements, the company intends to amend its previously filed reports on Form 10-Q for the quarter ended March 31, June 30 and September 30, 2001 to reflect these and any other required adjustments to its financial statements for those periods. Accordingly, investors should not rely upon the company's previously filed reports on Form 10-Q for those quarters or the financial statements contained therein.

> Because the inquiry by the Audit Committee is not complete and the Audit Committee is examining a large number of transactions, there may be additional material restatements of the company's financial results once the inquiry is complete. The transactions under review include transactions that occurred in the year 2001, as well as transactions that occurred in the year 2000. The company cannot at this time quantify the amounts of potential additional restatements. Any additional restatements, if required, could have further material adverse impact on the company's reported financial results. Such restatements could also include a restatement of financial results for the year ended December 31, 2000. The Audit Committee and the company are firmly committed to completing a thorough, expeditious inquiry of these matters in an independent, objective manner, and currently expect to complete the inquiry by the end of the first quarter of 2002. (Emphasis added)

283. Other commentators expressed concern that Homestore waited so long to admit that it would have to restate its revenue. On December 28, 2001, Bambi Francisco, a market commentator for CBS.MarketWatch.com, questioned "why [Homestore] chose to disclose the information on Friday, right before the weekend holiday." Francisco stated that a Homestore spokesperson, "would not comment on when [Homestore] decided to arrange the inquiry or when its board hired independent attorneys and accountants." Francisco queried whether Shew, who left Homestore after only being with the Company for ten months, was "aware of the potential restatements." Francisco suggested that the decline in advertising sales "ignit[ed] concerns that [Homestore] was playing loosey-goosey with its books."

284. On December 27, 2001, James J. Cramer of TheStreet.com questioned the choices made by Homestore regarding disclosure:

> Earlier this year, I praised Homestore.com. I didn't know at the time that it was doing things wrong with its accounting. This was in August, when I still felt it was being forthright. By October I recognized that things were wrong at Homestore and I communicated that, but I admit to being fooled by the folks at Homestore and I regret it. I point this out because I hate making such mistakes, mistakes that might have cost you money, and I apologize for it. The problem is, as always, you can't game accounting shenanigans. You can't game when people don't tell you the truth. I think people have to realize that when managements [sic] don't play it kosher, its very easy to be fooled. All of us are susceptible to being fooled because we start with the preconception that managements [sic] are honest. Had Homestore been honest, I would never have written about it positively.

285. Homestore's announcements shocked the markets. George Nichols, a Morningstar analyst wrote on January 3, 2001:

> The magnitude of this overstatement is quite staggering: Based on the company's current estimates, between 45% to 80% of total ad revenues for the past three reported quarters should not have been recorded as sales. Shareholders ought to bail out of the stock, although that's easier said than done considering the NASDAQ has halted trading in the shares since December 24.

286. A reported $118 million in advertising revenue for the first three quarters of 2001 had essentially evaporated. Upwards of 80% of such "revenue" was, in fact, barter transactions which should have been excluded from, or separately accounted for in Homestore's financial statements, accordance with ETIF No. 99-17. Reported earnings were also materially inflated for each of the periods. As the *New York Times* reported on January 27, 2002, the barter transactions were not simple ad swaps, but exchanges for goods and services. Brett Trueman, an accounting professor at the Haas School Business at the University of California at Berkeley, stated that Homestore vastly overstated the value of these transactions.

287. On January 7, 2002, three important events occurred. First, Homestore announced that Wolff was resigning and that it had appointed a new Chairman, Chief Executive Officer, Chief Operating Officer, and Chief Financial Officer. Second, Homestore issued a press release entitled, "Homestore Provides Additional Information to NASDAQ." Third, NASDAQ restarted trading in Homestore common stock. Homestore's common stock price fell 32% that day with a closing price of $2.46.

288. On January 16, 2002, Homestore issued a press release announcing that it had taken disciplinary action against several employees based on the inquiry conducted by its Audit Committee. Homestore terminated or accepted resignations from seven employees, three of whom had already been put on

administrative leave. Homestore stated that it was prepared to take additional future disciplinary action if the need arose. In pertinent part, Homestore stated:

> Before today, the company had placed three employees on administrative leave in connection with the audit committee inquiry and the company may take additional disciplinary measures because of the inquiry. The employees placed on leave were members of the finance department and business development department.

289. In September and October of 2002, DeSimone, Giesecke and Shew pled guilty in the United States District Court for the Central District of California to knowingly falsifying Honestore's revenue records.

F. The Fraudulent Accounting Scheme

290. By restating its financial results, Homestore has admitted that its publicly-issued financial statements for each of the restated periods were not prepared in conformity with GAAP, and that Homestore materially misstated its financial condition and results of operations. Under GAAP, the restatement of previously issued financial statements is reserved for circumstances where no lesser remedy is available. Under Accounting Principles Board Opinion No. 20, *Accounting Changes*, restatements are only permitted, and are required only to correct material accounting errors or irregularities that existed at the time the financial statements were originally prepared and issued.

291. The restatement of a company's previously issued financial statements becomes necessary when it is discovered that previously issued financial statements contained errors or irregularities in accounting which caused them to be materially misstated. Such misstatements can be the result of errors or fraud, and once discovered, the company is obligated to notify all parties who may rely on the previously issued financial statements that they should no longer place reliance thereon. The restatement of a company's previously issued financial statements is, in fact, an admission that such financial statements contained material misstatements that caused them to be misleading to the readers.

292. As a part of their scheme to defraud, Homestore and the Individual Homestore Defendants dramatically and materially overstated Homestore's revenues and assets for fiscal year 2000 through the third quarter of 2001, in violation of GAAP and SEC rules prohibiting "roundtrip" or "barter" transactions.

293. During 2000 and 2001, Homestore falsely inflated its revenues by entering into illegal triangular transactions wherein Homestore paid cash for the useless or unnecessary products. In turn, the vendor kept a designated portion of the cash paid for the product and used the remaining cash to purchase advertising. In the AOL transactions, for example, AOL kept a portion of the funds paid for the advertising and AOL then paid Homestore for the advertising purchased by the vendor. Homestore then knowingly and intentionally recorded the monies received from AOL as revenues from advertising, when, in fact, they were their own recycled monies and could not be recognized under applicable accounting standards.

294. In May 2000, Homestore and AOL Time Warner entered into a five year, $287 million marketing, content and distribution contract, dated April 25, 2000. The new contract was an expansion of a 1998 agreement between the companies, under which Homestore provided AOL sites with a variety of real estate-related content. Under the new alliance, Homestore became the exclusive national provider of professional home and moving services across AOL, AOL.com, CompuServe, Netscape Netcenter and Digital City platforms. Homestore gave AOL $20 million in cash and 3.9 million shares of its stock in exchange for advertising space on AOL's web sites. At the time, the Homestore outstanding shares were valued at $186 million. Additionally, under the terms of the agreement, Homestore had to give AOL over 2.3 million shares with a guaranteed closing price of $68.50 per share. The agreement contains a "make good" provision in which Homestore promised to pay AOL the difference in cash if its share price fell below the $68.50 per share mark. Homestore now alleges that

AOL breached this contract by not directing enough of its visitors to Homestore's web site.

295. Homestore discussed its revenue sharing agreement and pending arbitration with AOL Time Warner in its 10-K for 2001. In pertinent part, Homestore stated:

> We are currently in arbitration with AOL relating to a distribution agreement dated April 25, 2000, under which AOL was to promote the content of Homestore and, among other things, Homestore was to become the sponsor of and content provider for new house and home-related channels on the AOL network. Pursuant to the Distribution Agreement, we made an up-front cash payment to AOL of $20,000,000 and delivered to AOL nearly 3.9 million shares of Homestore stock with a guaranteed value, supported by a $90 million letter of credit to AOL. Under the distribution agreement, AOL was entitled to draw down the letter of credit upon any event of termination, even if we terminate for breach of the agreement by AOL.
>
> We filed a Demand for Arbitration with the Arbitration Association of America (AAA) in Atlanta on October 30, 2001, and a First Amended Demand for Arbitration on January 18, 2002. In the First Amended Demand, we claim that AOL has breached the distribution agreement by failing to meet its contractual obligations to build 21 specific promotions for Homestore and to deliver more than 600 million Homestore impressions to AOL users. We also claim that AOL breached the duty of good faith and fair dealing in the contract by disregarding its contractual commitments. On March 4, 2002, we moved to file a Second Amended Demand for Arbitration, adding the claim that AOL's conduct violated the contractual guarantees of exclusivity, premiere partnership and prominent partnership for Homestore. In the arbitration, we seek a declaration that AOL breached the distribution agreement; that we may terminate or rescind the contract and receive damages and other appropriate relief; and that Homestore may terminate the contract without AOL having any right to the $90 million letter of credit.

G. <u>Violations of SEC Rules</u>

296. Defendants violated Item 303 of Regulation S-K under the federal securities laws, 17 C.F.R. §229.303, when they failed to disclose the existence of these trends and uncertainties that they reasonably expected would have a materially unfavorable impact on net revenues or income or that were reasonably likely to result in Homestore's liquidity decreasing in a material way. Defendants' failure to disclose what they knew rendered their statements made during the Class Period materially false and misleading.

H. Violations of Accounting Rules

297. GAAP are recognized and used by the accounting profession in order to define acceptable accounting practices at a particular time. The SEC has also endorsed GAAP in Regulation S-X, 17 C.F.R. § 210.4-01(a)(1), which provides that financial statements filed both annually and quarterly with the SEC must comply with GAAP. If the filings do not comply with GAAP, they are presumed to be misleading and inaccurate, despite footnote or other disclosure. Therefore, Defendants' misleading statements and omissions, described above, violated GAAP and SEC Regulations.

298. Statements of Financial Accounting Standards ("FAS") are the highest authority in GAAP and are created by the Financial Accounting Standards Board. GAAP provides other authoritative pronouncements, including Accounting Principles Board Opinions ("APB") and Statements of Position ("SOP") of the American Institute of Certified Public Accountants ("AICPA").

299. The responsibility for preparing financial statements that conform to GAAP rests with corporate management, as set forth in Section 110.03 of the AICPA Professional Standards:

> The financial statements are management's responsibility. Management is responsible for *adopting accounting policies and for establishing and maintaining internal control*, that will, among other things, record, process, summarize, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements. The entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management . . . . Thus, the fair presentation of financial statements in conformity with [GAAP] is an implicit and integral part of management's responsibility.

300. Pursuant to these requirements, Homestore represented in its reports filed with the SEC that its financial results were presented appropriately in accordance with GAAP. Nevertheless, Defendants knowingly disregarded the following fundamental GAAP when preparing its financial statements:

> (a) Interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements (APB No. 28, ¶ 10);

(b) Financial reporting should provide information that is useful to present and potential investors, creditors and other users in making rational, investment, credit and similar decisions (FASB Statement of Concepts No. 1, ¶ 34);

(c) Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and matters that change such resources (FASB Statement of Concepts No. 1, ¶ 40);

(d) Financial reporting should provide information about how management of an enterprise has discharged it stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it (FASB Statement of Concepts No. 1, ¶ 50);

(e) Financial reporting should provide information about an enterprise's financial performance during a time period. (FASB Statement of Concepts No. 1, ¶ 42). This information is often used by investors and creditors in order to evaluate whether they are interested in future investment and credit offerings;

(f) Financial reporting should be reliable and relevant in that it represents what it purports to represent (FASB Statement of Concepts No. 2 ¶¶ 58-59);

(g) Financial reporting should be complete, in other words, all information that may be necessary to assure that it validly represents underlying events and conditions must be provided (FASB Statement of Concepts No. 2, ¶ 79);

(h) Financial reports should be conservative. Preparers must adequately consider uncertainties and risks inherent in business situations and reflect those issues in the reports (FASB Statement of Concepts No. 2, ¶¶ 95, 97); and

(i) Revenue must be realizable (collectible) and earned prior to recognition (FASB Statement of Concepts No. 5, ¶ 83).

301. Throughout the Class Period, all the material misrepresentations and omissions particularized in this Complaint were disseminated and/or approved by Defendants and those actions were a direct cause of the damages sustained by the Plaintiff and the Class.

I. <u>Homestore's Restatement of Its Financial Statements</u>

302. Homestore's barter transactions did not meet the requirements of EITF No. 99-17 for recognition of revenue from advertising barter transactions. Moreover, Homestore's financial statements for the year ended December 31, 2000 were not prepared in accordance with GAAP. Homestore's advertising

barter transactions were related to puchases of goods and services from other entities.

303. Moreover, Homestore's restated financial statements for the year ended December 31, 2000 failed to present sufficient information on the advertising transactions to be in compliance with EITF No. 99-17.

304. Homestore's improperly recognized revenues accounted for 52.8% of Homestore's advertising revenue and 22.8% of total revenue for fiscal year end 2000. According to former senior executives of Homestore, it is not possible for an audit of the financial statements performed in accordance with GAAS to fail to discover these transactions given the pervasiveness of the conduct and the fact that it often occurred right at the end of a period in order to "make the numbers."

305. Due to Homestore's improper conduct, Homestore was forced to restate its materially misleading financial statements, filed with the SEC in their Form 10-K for 2000 and the Form 10-Qs for the first, second, and third quarters of 2001. In Homestore's Form 10-K/A for the fiscal year ended December 31, 2000, filed March 12, 2002, Homestore made the following restatements and adjustments: (*in thousands*, except per share amounts).

Quarter Ended March 31, 2000

	As Reported	Restated	Difference
Revenues....................................	$38,599	$37,622	$977
Gross Profit................................	$27,841	$26,904	$937
Loss from Operations......................	$33,607	$33,607	$0
Net Loss Applicable to Common Stockholders..............	$29,212	$29,212	$0
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders..............................	$0.39	$0.39	$0

Quarter Ended June 30, 2000

	As Reported	Restated	Difference
Revenues....................................	$50,152	$42,244	$7,908
Gross Profit................................	$36,719	$28,811	$7,908
Loss from Operations......................	$30,986	$35,558	$4,572
Net Loss Applicable to Common Stockholders..............	$24,712	$29,284	$4,572
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders..............................	$0.31	$0.37	$0.06

Quarter Ended September 30, 2000

	As Reported	Restated	Difference
Revenues......................................	$62,203	$48,835	$13,368
Gross Profit..................................	$45,878	$32,998	$12,890
Loss from Operations.......................	$32,851	$40,439	$7,588
Net Loss Applicable to Common Stockholders...............	$27,058	$33,946	$6,888
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders...............................	$0.33	$0.41	$0.08

Quarter Ended December 31, 2000

	As Reported	Restated	Difference
Revenues......................................	$79,013	$52,581	$26,432
Gross Profit..................................	$57,290	$31,387	$25,903
Loss from Operations.......................	$33,074	$52,498	$19,424
Net Loss Applicable to Common Stockholders...............	$34,187	$53,611	$19,424
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders...............................	$0.41	$0.65	$0.24

(Homestore Form 10-K/A for 2000, pp. 59-60).

306. For the year ended December 31, 2000, Homestore reduced its reported revenue by $48.6 million and increased its net loss from $115.2 million to 146.1 million. Homestore also increased its net loss per share from $1.44 to $1.83 (Homestore Form 10-K/A for 2000, p. 4).

307. Homestore was forced to make similar restatements and adjustments to its financial statements for the first, second, and third quarters of 2001 in its Form 10-Q/As, filed March 29, 2002 (*in thousands*, except per share amounts):

Quarter Ended March 31, 2001

	As Reported	Restated	Difference
Revenues......................................	$105,491	$61,341	$44,150
Gross Profit..................................	$77,463	$36,013	$41,450
Loss from Operations.......................	$58,803	$91,465	$32,662
Net Loss Applicable to Common Stockholders...............	$67,148	$99,810	$32,662
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders...............................	$0.71	$1.05	$0.34

(Homestore Form 10-1Q/A for 2001, p.7).

Quarter Ended June 30, 2001

	As Reported	Restated	Difference
Revenues......................................	$129,283	$69,067	$60,216
Gross Profit..................................	$95,265	$44,349	$50,916
Loss from Operations.......................	$72,491	$120,722	$48,231

Net Loss Applicable to Common Stockholders	$72,075	$120,868	$48,793
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders	$0.67	$1.12	$0.45

(Homestore Form 10-2Q/A for 2001, p.8).

Quarter Ended September 30, 2001

	As Reported	Restated	Difference
Revenues	$116,135	$76,588	$39,547
Gross Profit	$84,399	$54,586	$29,813
Loss from Operations	$86,611	$118,272	$31,661
Net Loss Applicable to Common Stockholders	$106,604	$138,325	$31,721
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders	$0.96	$1.25	$0.29

(Homestore Form 10-3Q/A for 2001, p. 9). For the first three quarters of 2001, Homestore reduced its reported revenue by over $143.9 million and increased its net loss from $245.8 million to 359 million. Homestore also increased its net loss per share from $2.34 to $3.42 (Homestore Form 10-Q/As for 2001).

J. Scienter and the Conduct of the Corporations

1. AOL Time Warner

308. In 1985, America Online Inc. ("America Online") began as a small online Internet company. In 1992, it went public on the NASD stock exchange with help from Kleiner Perkins Caufield & Byers who received a seat on the Board of Directors. While in 1994, it only had one million members, by 1997, two years after it had introduced "instant messaging" and begun trading on the NYSE, it had ten million members. Its 1997 Annual Report states: America Online "is the global leader in interactive communications and services, with nearly 7,500 employees and 45 locations in the U.S. and abroad." Its total 1997 revenue was $1,685,228,000, up from $1,093,854,000 in 1996 and $324,290,000 in 1995. In addition to member subscription fees, America Online depended on advertising for revenue. Like all Internet companies, America Online was a revenue driven company and it was continually looking for advertising alliances to increase revenues to increase its valuation. According to an August 12, 2002 *New York*

Times article, AOL entered into numerous barter transactions with Compaq Computer, Nortel Networks, Foundry Networks and small Internet companies in order to increase revenues. The transactions would involve the transfer of a combination of cash and online ads for in-kind payments of equity, equipment or advertising. AOL would treat the value assigned to the in-kind payments as sales revenue. Plaintiff's counsel investigation has revealed that Homestore and AOL entered into fraudulent transactions designed to artificially inflate each companies' revenues.

i. The Early Relationship with Homestore

309. It was the intent of senior management at Homestore, and in particular, Defendants Tafeen and Wolff, that Homestore would monopolize the real estate Internet market by parlaying Cendant's market power over listings with AOL's Internet market power. Cendant and AOL, and the relationships developed between them and Homestore, were the two cornerstones of the Homestore business model. As alleged below, Cendant, with its relationship with the National Association of Realtors ("NAR") not only had some of the most lucrative real estate brokerage franchises in the United States, it also accounted for as much as 30% of the total listings on the Multiple Listing Service ("MLS"). AOL, on the other hand, did not have an exclusive real estate channel as of 1998 when Homestore entered into its first deal with AOL.

ii. The First AOL/Homestore Deal

310. The relationship between Homestore and AOL started in April of 1998, before Homestore became a publicly traded company. Homestore was in the process of gearing up for its IPO, was hiring senior management such as Giesecke and Shew, and was hiring hundreds of employees under a internal project known as "Project Everest." Tafeen and Wolff were entering into distribution deals with a number of Internet companies like Infoseek, Lycos, and Excite. The intent was to develop a dominate market share over real estate Internet traffic, and through

these distribution deals, Homestore had eliminated much of the competition except for Cendant's Internet product offered by its subsidiary Move.com, a company it later acquired. There was also ongoing concern that Microsoft would somehow enter the market. Thus, the Cendant listings and the AOL Internet traffic were essential components of Homestore's future success.

311. In April of 1998, Homestore used the money it had raised in Series E and F financing to purchase from AOL the exclusive right to have the only online real estate listing product on AOL. Homestore purchased this exclusive right to be the real estate site on AOL for $20 million to be paid in installments as well as 1.5 million Homestore warrants. See Section II(c)(1)(i). Under this arrangement, Homestore would be featured on AOL, and an AOL user would simply click on a Homestore link, and be taken to the Homestore web site which was on a Homestore server as opposed to the AOL servers. This was the precursor to the "House & Home" channel that Homestore later established on AOL. The exclusivity deal with AOL gave Homestore a monopoly on the traffic on AOL for real estate. This also was the beginning of a trend for future deals wherein Homestore used its stock as currency to support deals that were supposedly based on the fair market value of the services and products provided.

iii. The Second AOL/Homestore Deal

312. After Homestore went public, it entered into a second deal with AOL which involved an advertising reseller agreement. This deal was made by Tafeen with the involvement of Losh and was consummated in March 1999. This deal established the framework for how other similar deals would work, and generated extensive discussion amongst the Business Development department, the Finance Department, and PWC about the nature of the revenues being recognized.

313. This deal had two legs. The first involved the advertising reseller agreement between Homestore and AOL whereby AOL would sell advertising on the Homestore site for which AOL would receive a commission as a sales agent.

AOL, in the second leg, would sell Homestore advertising to third parties who would, in turn, pay AOL for the advertising. Under this arrangement, AOL was the exclusive sales agent for Realtor.com and Homebuilder.com. In connection with this deal, senior management in the Finance and Business Development departments at Homestore determined that the gross revenues from the advertising sold by AOL would be recognized as opposed to being netted. Under the gross revenue recognition approach, 100% of the advertising revenues would be recognized by Homestore and the corresponding AOL commission would be an expense. This is materially different from netting the commissions from the gross revenues, which would not have allowed Homestore to recognize as much revenue. This deal involved the interpretation of certain accounting rules, including EITF 99-19, and PWC was very involved with the senior management of Homestore in structuring this deal so as to take advantage of the gross accounting method. Ultimately, this reseller arrangement was disappointing which led to discussions about terminating the deal early.

iv. The "House & Home" Deal

314. In May of 2000, Homestore and AOL announced new five-year multifaceted content, e-commerce and distribution alliance valued in excess of $200 million, to provide comprehensive home and real estate content to several key AOL brands.

315. This five-year marketing agreement was orchestrated by Tafeen at Homestore, and Keller at AOL. Tafeen and Keller had developed a relationship during their prior negotiations over the other deals between the two companies. Keller was the Senior Vice President under Colburn at AOL. Colburn was Executive Vice President and President of Business Affairs and Development for AOL and its chief dealmaker. Colburn was in charge of structuring many of AOL's advertising and commerce deals.

316. The heart of this deal was that AOL would obtain a large stake in Homestore by virtue of its receiving 3.9 million shares of Homestore stock at a guaranteed price of $68.50 per share. In exchange for this large block of shares, Homestore paid AOL $20 million. Simultaneous with, and included within the terms of the marketing agreement, AOL established the "House & Home" channel for which Homestore would be the exclusive content provider, as well as a revenue sharing agreement to share revenue generated from the traffic on the House & Home channel. As a result of this marketing agreement, both AOL and Homestore were financially motivated to keep Homestore's stock price high and avoid disappointing Wall Street which necessarily required Homestore to continue hitting its revenue targets.

317. In fact, Homestore's guarantee of its common stock at $68.50, when the stock was trading in the $20 range, at the time the deal was announced, made it clear that Homestore was very interested in achieving or exceeding the guaranteed price. This was particularly true given the fact that AOL had the right to cancel the marketing agreement at the end of three years if the guarantee on the stock price was not met. The transfer of stock and guarantee were pro-rated over the three year period at 60% the first year, 20% the second year and 20% the third year. Lastly, Homestore had to provide a $90 million line of credit on which AOL could draw to a $50 million cap if the guarantee was not met. This put enormous pressure on Homestore to get the stock price up from the $20 range as of the announcement of the marketing agreement with AOL, and to avoid the monumental losses that Homestore would suffer if the price stayed in the range it was in at the time the deal was announced. This was a financial reality that was known to the senior management at Homestore, including Tafeen who put the deal together, and the senior executives at AOL, including Colburn and Keller.

318. It was also significant that the stock deal was executed simultaneous with the House & Home exclusivity and revenue sharing arrangement. This deal

was the essence of "buying revenue," *i.e.* using the shares of Homestore as currency, and was the foundation for later deals between AOL and Homestore during Q1 and Q2 of 2001, whereby AOL knowingly participated with Homestore in the fabrication of revenues.

319. It was also critical from AOL's perspective that it be able to recognize revenues from the marketing arrangement. AOL recognized revenues, and in particular Colburn and Keller's department got credit for these revenues, as the shares were provided to AOL. Taking the guaranteed stock price and the $20 million in cash paid by Homestore, this marketing agreement was worth over $287 million to AOL over the three year term of the guarantee. This was enormously important to Colburn and Keller's department, and their internal positions at AOL.

320. There were numerous financial and accounting issues related to this transaction which raised "red flags" for both Homestore and AOL. In the first instance, the original terms of the deal which were worked out by Tafeen and Keller, among others, did not include the letter of credit, the triggering events for the letter of credit, the guarantee, nor the termination provisions. In addition, as originally negotiated, Homestore was not to provide the $20 million cash payment. In a phone conversation between Keller of AOL, and Shew of Homestore in March or April of 2000, Keller explained that AOL's auditors had looked at the proposed deal, and in order for AOL to recognize the revenue from the agreement, AOL had to have the $20 million cash payment, the letter of credit, and the termination provisions. Keller further explained that AOL would be recording approximately $50 million per year in revenue on the transaction. Keller also noted in these conversations that AOL needed to recognize these revenues, and that Colburn was directly involved in the negotiations of these terms. In fact, discussions between Colburn and Tafeen caused Tafeen to complain that he was "pissed off" because Colburn was trying to "f***" the deal by including these new

terms. The revenue recognition was essential for AOL, and in particular, Colburn and Keller's department.

321. There were numerous financial and accounting issues on the Homestore side of the deal as well. Ostensibly, the deal was promoted by Homestore as solidifying its position in the Internet real estate market, and further allowed Tafeen and Wolff to tout Homestore as the number one Internet real estate company. It also fulfilled the goals expressed by Wolff and Tafeen to block competition by establishing a partnership with AOL as well as "monetizing" the enormous traffic that AOL enjoyed. One of the first issues which raised a "red flag" was the fact that the revenue sharing agreement contained larger than usual commissions for AOL. In essence, AOL would establish the House & Home channel, and Homestore would provide the content for the channel. As a result, Homestore would be the exclusive provider of real estate listings on AOL. The number of "eyeballs" or the traffic generated on the House & Home channel was the basis for generating revenue under the sharing agreement. Under the terms of the agreement, AOL would get anywhere from 50 to 75% of the revenues from the House & Home channel depending on the level of traffic. One of the initial issues that arose in this regard was the size of the commission to AOL. Standard commissions were normally well below this, and the senior management of Homestore was well aware of this. So was PWC, whose senior audit engagement partner, Richard Withey, was an expert in the entertainment business and fully familiar with similar arrangements in other businesses that he audited including Disney.

322. Another issue which was discussed amongst the senior management at Homestore and PWC was the simultaneous nature of the transaction for the stock at the same time as the agreement for the revenue sharing on the products and services, as well as the guarantee at a level that was far in excess of the current price of the stock. The economic substance of the exclusivity agreement and the

revenue sharing had to withstand scrutiny with respect to the value of the new channel and the anticipated amount of traffic that could be projected. The model for this arrangement was the Budget/Ryder transaction done in Q1 of 2000 which also blended into a reciprocal transaction the provision of product combined with Homestore shares guaranteed at an artificially high price. The Budget/Ryder deal was also reviewed by PWC who had extensive input on its structure, and was the subject of numerous discussions with Homestore about valuation and reciprocal transaction issues. Based on the Budget/Ryder experience, whereby the stock price quickly dropped below the guarantee price, and the obvious interest of partners such as Budget/Ryder and AOL in Homestore stock, as opposed to the products or services offered by Homestore, both senior Homestore management and PWC knew that the Homestore stock was being used to buy revenues, and that the use of the stock as currency to buy revenues was not in the best interests of Homestore.

323. Another issue which was analyzed both by senior management at Homestore, and in particular by Tafeen, Wolff, Giesecke and Shew, and the PWC auditors, including Withey, was whether the guarantee requested by AOL was considered a derivative financial instrument or a liability. To the extent the guarantee and its terms were deemed to be a derivative financial instrument, then it would be subject to being "marked to market" and the corresponding charges against Homestore earnings would be unpredictable. This was in contrast to it being handled as a liability. Ultimately, having the guarantee deemed a liability was more favorable to Homestore. Giesecke was deeply involved in these discussions, and all members of senior management, including Wolff, Tafeen, and Shew were aware of these issues, as was PWC.

324. The issues were so essential to the deal with AOL that the audit engagement partner for PWC, Withey, got the National Office of PWC involved in reviewing these "red flags" and the National Office approved the transaction

finding that it was not a reciprocal transaction, that there was fair market value for the products and services provided, and that the guarantee was not a derivative financial instrument. This approval at the highest levels of PWC of yet another transaction where Homestore was "buying revenues" encouraged Homestore to undertake even more aggressive forms of these types of transactions and put under increasing pressure to produce revenues in order to keep the stock price up. The revenue recognition issues involved in this transaction, and the other similar transactions approved by Homestore and PWC, presented the highest level of audit risk for an Internet client such as Homestore which audit risk was compounded by the fact that AOL was a related party to Homestore, that Homestore had displayed a pattern of scrambling at the end of each quarter to meet its targets for revenues, that the targets were customarily set unusually high based on the performance of other e-businesses as opposed to the results at Homestore, and that Homestore, with PWC's knowledge, typically entered into large deals in the last few days of each quarter. According to Plaintiff's confidential sources, PWC was aware of each of these audit risks. Accordingly, senior management was under incredible pressure to produce revenues and to meet unreasonably high targets. The AOL deal, with its magnitude and visibility, only added fuel to this fire.

325. In September 2000, AOL launched the House & Home channel. This was the first major channel launch for AOL in a long time and was very different in that the content was being provided by Homestore. At this point, Homestore and AOL were inextricably intertwined in their joint interest to keep alive the myth of Homestore as the leader in the Internet real estate market based on its revenue performance and ability to continue to meet expectations in a market that was suffering a downturn. During this very period of time, senior management at Homestore was engaged in the dangerous trend of booking lower and lower quality revenues, becoming more aggressive in response to the pressure created by Wall Street's expectations, and PWC was becoming increasingly nervous about

the type of deals being done, the structure for which was a direct result of PWC's continued tutoring on how to use the accounting rules to Homestore's advantage. Moreover, given AOL's huge stake in Homestore, Colburn and Keller's strong desire to generate revenues for their group, this deal set the stage for AOL becoming a knowing participant in the financial fraud that ultimately brought about the massive restatements alleged herein.

v. <u>The Q4 Revenue Deals</u>

326. As part of the reseller agreement between Homestore and AOL, advertising was placed by AOL on Homestore's web site for two companies called Oxygen Media and CUC. An immediate "red flag" was apparent given that CUC was a Cendant subsidiary. This heightened the degree of inquiry that should have been made by the financial department at Homestore as well as by PWC, neither of whom questioned this fact. Kalina, in Business Development at Homestore, was primarily responsible for doing these deals. PWC was also deeply involved. The critical issue which was raised about these advertising revenues was again the booking of revenues on a gross basis. PWC approved the booking as gross revenues for these Q4 2000 deals, and they were so booked by Homestore. In Q1 2001, an auditor from PWC, manager Christian Jester, came back onto the engagement team for the fiscal year end audit, and despite the fact that PWC had agreed to the gross revenue treatment in its quarterly review work for Q4, Jester said he would not agree to Homestore's booking the revenues in this manner for purposes of the 2000 year end audit. This resulted in the preparation of a schedule of proposed adjusting journal entries by PWC wherein it recalculated the revenues on a net basis for the subject deals. Homestore refused to make the adjustments even after the matter was discussed in detail with Kalina and became commonly known in the Finance Department. Senior management and the Audit Committee were advised of the disagreement, and in a presentation to the Audit Committee in early 2001, PWC expressed disagreement with the manner in which

the transactions were booked, but ultimately passed the adjustments as immaterial, and decided not to qualify its audit opinion over the disagreement.

327. The disagreement over the propriety of accounting for these transactions on a gross versus net basis was the subject of discussion between Homestore and PWC throughout the preparation of the 2000 year end audit. Giesecke, Kalina, and Shew were completely familiar with the disagreement and the ultimate compromise outcome that allowed Homestore to book the revenues. The handling of these transactions caused Shew, to become angry over the fact that PWC had already approved the transactions, and subsequently told Homestore, and Kalina, in particular, to be careful about how aggressive they were being in their revenue recognition practices. In fact, as repeated to Shew, Jester had made comments at a PWC meeting that Homestore was being too aggressive in their revenue recognition, and that they should be careful.

vi <u>The R&O Schedules and the "Plug" or "Bogie"</u>

328. As a common practice throughout 2000 and 2001, senior management at Homestore, including Wolff, Tafeen, Giesecke, and Shew, were provided with computerized schedules called "Risk and Opportunities" schedules ("R & O"). <u>See</u>, Exhibit E, which are examples of these schedules. According to Plaintiff's confidential sources, PWC saw these Risk and Opportunity schedules. The sole purpose of these schedules as known to senior management at Homestore was to gauge the quality of anticipated revenues for a quarter, and to determine what the shortfall would be in hitting the revenue target or "plug" as it was commonly and openly referred to by senior management. On these sheets, revenues were listed by their quality, and the senior management at Homestore commonly referred to some revenue as "good quality" and other revenues as "low" or "marginal" quality. Beginning in 1999, the custom developed that "good quality" revenue promised by Business Development executives, and in particular Tafeen, did not materialize causing Homestore to enter the last few days of a quarter scrambling to

make the "plug." This "plug" was also referred to as making the "bogie." It was absolutely essential to senior management that they make their revenue targets, because the "plug" or "bogie" was the revenue figure needed to satisfy Wall Street. Wolff and Tafeen were adamant that Homestore not be one of the e-business companies that did not meet its projections, and were literally obsessed with staying on the same revenue growth trends as their perceived peers such as eBay and Amazon.com.

329. In the context of this pressure to make the "plug" number, Tafeen, and Keller of AOL spoke on a number of occasions in late 2000 about the fact that AOL had not provided the promised traffic under their revenue sharing agreement, and owed Homestore $10-20 million in "good" revenue. Tafeen told senior management in the Finance Department that Keller and he had agreed that these good revenues would be coming through an AOL company called Digital City. Tafeen also told other senior executives at Homestore that Colburn was responsible for coming in and changing the House & Home deal which he and Keller had worked out. Colburn and Keller both knew, based on their conversations with Tafeen, that Homestore would be looking to AOL for "good" revenues to help make their numbers in Q1 2001, and that Tafeen believed AOL owed Homestore as much in light of the changes in the House & Home deal and the undelivered traffic associated with that deal.

330. The deals between AOL and Homestore, before Keller was placed on administrative leave in June 2001, were orchestrated by Tafeen and Keller with the knowledge and approval of Keller's superior, Colburn. In fact, deals that were made at the very end of the quarters to make the "plug" were commonly referred to as "Peter Deals" or "Peter Specials" at Homestore.

vii. <u>The Q1 Triangular Deal Was So Perfect</u>

331. In March 2001, Tafeen entered Shew's office and closed the door. This was unusual because Tafeen was typically open and gregarious, and did not

appear to care what anyone overheard him say. Tafeen told Shew that he was $15 million short of the Homestore revenue target for the first quarter, or the "bogie." Tafeen was intimately familiar with the R&O schedules, and knew that if they missed their target, the stock price would be hammered. Tafeen stated there were no other deals to make up for the shortfall, and this caused him to turn to Keller and Colburn at AOL. Drawing from the experience he had with structuring marginal revenue deals in the past with the help and guidance of PWC, Tafeen said that he and Keller jointly developed an idea for a triangular deal to save the quarter. On leg of the triangular deal would involve Homestore paying purported third party vendors for some service or product that they did not really need, a hidden second leg involving the quid pro quo for the first leg, where the third party vendor would buy Homestore advertising with AOL, and a third leg where AOL would "round trip" the money back to Homestore. This was the epitome of buying revenue, and in the short sighted desperation of making the "bogie," Tafeen was unconcerned that Homestore would be getting less cash back than it put in after AOL took its share. The all important impetus of the deal was to make the target revenue number, and not be worried about cash flow.

332. Tafeen explained how the deal would have to be structured in a way that kept PWC from finding out about the hidden leg. Tafeen told Shew that the structure was "scary in how perfect it was." Tafeen said he did not like it, but it was the only way to make the revenue target. Tafeen then asked Shew what he thought, and whether the structure would comply with GAAP or, in the alternative, could it be hidden from PWC. Tafeen was asking Shew to assess the likelihood that PWC would discover the structure. Shew said he wanted to discuss the structure with DeSimone and Kalina, but when he approached them, it was obvious that they already knew about it.

333. The concept for this sham deal with AOL was the cumulation of the evolution of deals that had been going on since 1999 as herein above alleged. At

their core, the deals were structured to buy revenue. In 1999, deals were made by Homestore using warrants to induce others to provide Homestore with revenue. In 2000, the deals evolved into distribution deals whereby Homestore would invest in the distributor company. There were also deals whereby Homestore paid for equity and services. And finally, there were the triangular deals of 2001.

334. Throughout the course of this evolution, PWC was actively advising Homestore on how to structure the deals to comport with the accounting rules, and consistently chose to ignore numerous “red flags” which showed that the economic substance of the deals was not consistent with the pure form. As alleged below, a number of the transactions which PWC approved were with related parties and required a higher level of scrutiny to make sure that the transactions were actually arms’ length. The AOL triangular deal came on the heels of PWC becoming ever increasingly concerned about the aggressive revenue recognition practices at Homestore. PWC had raised questions about the recognition of revenues in Q4 2000 associated with the Privista and PromiseMark deals, but the revenues were permitted. However, during the same time period, they did not allow the recognition of revenues on the Akonix and City Realty deals. Tafeen had expressed frustration that the rules kept changing on him and he kept having to adjust the structures.

335. The triangular deal with AOL for Q1 2001 was relatively simple. As known to all the participants at Homestore, including Tafeen, Wolff, Giesecke, Shew, DeSimone and Kalina, as well as the participants at AOL, including Keller and Colburn, Homestore would not document the agreement by the third party vendors to buy the advertising from AOL. Each of the participants at Homestore discussed how to do the deal in this fashion so as to avoid detection. Within the Finance Department, Shew even put together a fall back position in case PWC raised any questions. He had the Finance Department put together some fair market value analyses to support why Homestore bought unnecessary services or

products from the third party vendors. Some of these third party vendors were introduced to the deal by Tafeen and others by Keller.

336. As soon as he got done talking to Tafeen, Shew went in to talk to Giesecke. Shew told Giesecke the plan in detail as conveyed by Tafeen, and discussed the evolution of the structures allowed by PWC. Giesecke acknowledged that he was aware of the increasing scrutiny by PWC and asked Shew if Shew thought "it was completely wrong?"

337. The gross amount of the revenues from this first AOL triangular deal were $15 million for Homestore, or the necessary "plug" on the R&O schedules. The third party vendors used in the deal were PurchasePro, Investor Plus, FX Consultants, Classmates.com, Wizshop, and EasyRoommates. The deal came with enormous costs and cash flow impairments to Homestore as AOL would keep over 50% of the "round tripped" proceeds pursuant to the terms of the revenue sharing agreement. In fact, DeSimone prepared a schedule which estimated the cost of buying these revenues at approximately $14 million which said schedule was reviewed and discussed with Shew and Giesecke. The cash position of Homestore was negatively impacted by this deal, but that was the cost of buying revenues instead of creating them legitimately.

338. A number of efforts were made internally at Homestore to cover up the deal with AOL. First, the Homestore Finance Department prepared fair market value analyses to fend off questions from PWC. Second, the Homestore Finance Department looked at the third party vendors, and any parent or controlling companies of the same, to determine whether PWC audited any of them. If PWC did audit one of the third party vendors then they could discover the hidden leg. Homestore's senior management also had accounting schedules which were reviewed at meetings attended by Wolff, Tafeen, Giesecke and Shew and that were known to others in the Business Development and Finance Department. These accounting schedules charted the cost of doing the triangular deals and depicted

the costs of undertaking the triangular deals as "SAG carry-over costs." All those who saw the schedules, including Wolff, knew these were the amounts spent to buy the revenues which would not be coming back as a result of the AOL commission.

339. In late March of 2001, PWC started asking questions about the first AOL triangular deal. The questions were posed by Withey who belatedly started to question the very high commission structure. Withey explicitly asked Shew why the commission structure was so high, but accepted a fairly superficial answer from Shew and never revisited the issue. There were also discussions between PWC and senior management at Homestore about PWC's concerns relating to other deals including Bank of America, Akonix and City Realty, and how the concerns related thereto may be applicable to the AOL triangular deal in Q1 2001. However, despite these questions on points which were apparent "red flags," PWC did not question the deal in their quarterly review process even though it was a quarter saving revenue recognition item, with a related party, right at the end of the first quarter 2001.

viii. <u>The Reason For Crossing The Line: The AOL Merger</u>

340. Each of the individual members of senior management at Homestore as well as AOL knew that the Q1 triangular transaction between Homestore and AOL had crossed any possible line of inappropriateness under the revenue recognition rules. At Homestore, the senior executives like Tafeen, Wolff, Giesecke, and Shew rationalized that they would only have to concoct one triangular transaction because Homestore was in merger discussions with AOL. In fact, Wolff specifically said to Shew, when he discussed this first AOL triangular transaction with him that Homestore would not have to do these type of deals again because AOL would be buying Homestore or the economy would take care of any future concerns. These merger discussions began in the March 2001 time

frame between Tafeen and Keller. As told to Shew, Tafeen and Keller had a discussion where Tafeen said, "just buy us." A formal meeting was held with Wolff about a potential merger with AOL on March 23, 2001. Shortly thereafter, financial advisers were retained (Homestore retained Morgan Stanley) and in honor of the NCAA basketball championships, the potential merger was dubbed "Final Four." On or about March 27, 2001, Tafeen called a meeting, which included Shew, to discuss the specifics of the possible merger. An acquisition model had been prepared and presentations done as they would be given to senior AOL executives in New York, including Colburn and Keller.

341. The merger or acquisition would be a savior to Homestore as the Q1 triangular transaction would get lost during consolidation of the two entities and would not be material to the merged company. In addition, analysis was done at Homestore about the accounting treatment for the potential merger which would cause the costs to Homestore of the triangular deals to be written off, thereby providing another layer of cover to keep the transaction from being detected. The discussions became so serious that the following specifics were addressed:

- Within Homestore, compensation packages were being reviewed as well as stock options. Senior management at Homestore stood to make millions on a potential merger. Wolff could potentially net as much as $100 million at $35 per share. Giesecke and Tafeen stood to make $15 to 25 million, and Shew $5 million. This, of course, was contingent on Homestore keeping the share price as high as possible.
- Within Homestore, triggers on change in control and acceleration of options were being discussed and reviewed with the compensation committee.
- Wolff was working on an employment agreement with AOL.
- AOL was struggling with how to handle the potential loss of the $50 million revenue recognition from the House & Home deal. AOL's

stock was not performing well, so the elimination of the revenue through a merger could be harmful. At Homestore, Shew, Kalina and DeSimone worked on solving this problem.

342. Incredibly, part of the benefit to Homestore, which was discussed in the Finance Department, was the fact that AOL would write off the third party vendor deals as part of the consolidation. These would be written down in the acquisition as worthless assets, despite the fact that there was supposedly valuable consideration given in the form of product or services by these vendors, and Homestore had been preparing fair market evaluations to support the deals. Wolff and Tafeen were made aware of this write off methodology by Shew at or about the time they attended meetings in New York with AOL to discuss the merger. The write offs were a very convenient way to wash out one portion of the Q1 AOL deal. Until the talks stalled sometime in May 2001, the senior management at Homestore considered the "Final Four" acquisition by AOL to be one way out of having done the fraudulent first quarter 2001 revenue deal. The talks stalled when the acquisition became too rich for AOL as the stock price of Homestore climbed on the release of the results Q1 2001. The increase in the stock price during this period made the value of the deal approximately $4 billion, and AOL was still struggling with the merger with Time Warner.

ix. <u>The April 2001 Audit Committee Meeting</u>

343. An Audit Committee meeting was held at Homestore in April 2001, and was attended by, among others, Shew, the members of the committee and PWC. Shew led specific discussions about the Q1 AOL deal, and the discussions were purposely directed towards booking of gross versus net revenues under EITF 99-19. PWC auditors attended the meeting and spoke about the handling of the revenues on a gross basis as well as the amount of the commission being paid to AOL. Withey attended on behalf of PWC. Withey stated that PWC allowed the AOL Q1 deal to be booked on a gross basis, but advised that it should not be done

again. The Audit Committee did not object, but expressed concern about the risks involved in booking the revenues on a gross basis. However, the meeting took place the day before the pre-earnings release was to go out, and the Audit Committee determined that in light of the complexity and timing of the presentation on the issue of gross versus net revenues, and given the fact that PWC had reviewed the transaction, they would let it go through this time. However, Audit Committee member Barbara Alexander stated her specific concern about the transaction, and the Committee asked for an outline of recurring accounting issues in advance of the next meeting. PWC then discussed the fact that Homestore was dependent on large non-recurring strategic deals which came in right at the end of the quarter, like the AOL Q1 deal. The Audit Committee reviewed a chart depicting such large strategic deals, and PWC explained their position on two such deals: Akonix and City Realty. Withey did not formally challenge the deals, but strongly urged that they not be booked and told the Audit Committee that since Homestore did not need the revenues from these deals to meet there revenue target and could meet Wall Street's expectations without them, that they did not have to book them. In other words, PWC, like senior management, was conditioned to evaluate revenue in light of its role in meeting revenue targets, and chose to ignore the obvious "red flags" about the Q1 AOL deal.

x. <u>The April 11, 2001 Lunch Between Wolff and Shew</u>

344. On April 11, 2001, in the midst of the AOL merger discussions, Wolff had a lunch meeting with Shew at Rustica in Westlake Village. The lunch lasted for around one hour, and after small talk, Shew told Wolff point blank that he did not like the Q1 AOL deal. Shew said he did not feel right about facing PWC, but did not elaborate. Wolff did not question what transaction he was talking about and acted as if he knew exactly what Shew was worried about. Wolff simply confirmed that he also did not like the deal, but reiterated the

standard rationale for doing it; that it would be a one time situation and that the AOL acquisition or an upturn in the economy would solve the problem.

xi. Crossing the Line Again: The Q2 AOL Deal

345. In April of 2001, an R&O schedule was circulated by finance that showed a $20 million AOL deal. Tafeen assured the Business Development and Finance Departments that it was legitimate revenue, but Shew, DeSimone and Kalina were skeptical of that representation. According to Tafeen, this was the $20 million which AOL owed Homestore as a result of the traffic not being as promised on House & Home, and he attributed it to an AOL subsidiary, Digital City. The amount of the AOL "owed" revenues changed on a May R&O schedule to $25 million. Thus, at that point in time it became apparent that this was another "Peter Deal" and highly unlikely that it was a legitimate $25 million revenue "opportunity," especially since it still appeared on an R&O schedule prepared in June 2001, just before the close of the quarter. See, Exhibit E.

346. As of the Q1 earnings release on April 25, 2001, there were total unidentified revenues on the R&O schedule of $25-30 million. When finance analyzed the schedules, it became apparent that there was actually $40 million of revenue for which they had no deal; in other words, the "plug" for Q2 2001 was $40 million. This was an enormous and insurmountable "plug" and both Tafeen and Wolff were aware of this. Wolff and Tafeen told Shew that they did not have the deals to fill the plug, and they were in trouble if they could not do so. At this point in time, there was only 60 days to go in the quarter, and no obvious way to make up the shortfall. In fact, by June 21, 2001, the R&O schedule showed $76,172,000 in revenue "risks" and $73,675,000 in revenue "opportunities" for a shortfall of $6,993,000. This is denoted as "Unidentified Income/Expenses Required to Achieve Target." The "opportunities" included $25 million from AOL.

347. This situation was compounded by Wolff's obsession with setting the Homestore revenue targets at or above other high flying Internet companies. In the April 2001 time frame, Wolff was setting Homestore growth targets based on those of eBay, and thus creating the double problem of not having deals to meet the targets, and the targets being consistently too high to achieve. This situation had been ongoing and apparent for some time, and was an obvious "red flag" for PWC who necessarily evaluated the audit risk at Homestore by assessing how aggressive revenue targets were and what type of machinations had to be undertaken to meet the targets. This was a particularly egregious "red flag" in light of the fact that the company seemed to make its numbers miraculously in the last few days of the quarter with material revenue deals orchestrated with related parties. There were several discussions during this time period about re-setting the revenue guidance and conditioning the Wall Street for Homestore not meeting their target. This was discussed among Wolff, Shew and Giesecke. They decided that the Wall Street's expectations for Homestore were very high and that a downward adjustment in guidance would result in a severe reaction. Between the stalled AOL acquisition talks, Wolff's exceptionally unrealistic revenue targets, and the $40 million shortfall, the situation became desperate. Some in the Finance Department referred to the setting of targets against other Internet companies like eBay was a "meet and beat" syndrome.

348. During this same period of time in April 2001 and continuing into May 2001, Homestore's senior management was also trying to assess the costs involved in doing the triangular deals like the Q1 AOL deal. In addition to a schedule prepared by DeSimone which showed the impact on cash flow of these deals, Wolff presented a schedule at a May meeting attended by Tafeen, DeSimone, Giesecke and Shew, which showed the hidden leg of the triangular deals in order to assess how much it was costing Homestore. This schedule outlined the "round tripping" of the funds that started with Homestore paying the

third party vendors through AOL and back to Homestore. This schedule made the round trip nature of the subject transactions apparent to anyone at the company who saw it, and depicted the link between the flow of money through the hidden leg. These schedules bred additional meetings on the "round trip" deals and caused Tafeen to develop his own schedules on the same topic.

xii. <u>The Meeting At Cal Amigos On May 7, 2001</u>

349. The company had scheduled an off-site meeting at the Cal Amigos Ranch to discuss management issues and a pre-meeting had been arranged between Wolff, Tafeen, Giesecke and Shew to discuss the impending failure to meet revenue expectations and the need to do bogus deals to meet the Q2 expectations. Shew wanted Giesecke's support to confront Wolff and Tafeen on the issue at hand. Shew, in particular, knew that the positive statements generated by Tafeen to Wolff about good revenues coming in did not usually pan out, and he wanted to call Tafeen on it.

350. The pre-meeting was supposed to be at 8 a.m. before the general executive meeting. Wolff was late to the pre-meeting, and the general group had already begun to assemble. So, Wolff, Giesecke, Tafeen and Shew met semi-privately in a sitting area off the main room. They first discussed the R&O schedule which showed that Homestore was now $40-50 million short of the "plug." All four top executives were fully familiar with these schedules and as a general business practice used them to gauge what had to be done to make the "plug" number. Shew and Tafeen did most of the talking, and stressed the urgency of the shortfall as half the quarter was already gone. Ideas were solicited from Tafeen and Wolff specifically asked if there was any other source available for good revenues. Tafeen responded that there was AOL, Cendant and barter deals. Wolff wondered out loud: "Where do we get the revenue?" The entire focus of the discussion was how to buy revenue.

351. Wolff, Tafeen, Giescke and Shew all realized that in light of PWC's objection to Akonix and City Realty, they could not do "true barter" type transaction which they had to keep at a level of 5% or below to avoid scrutiny. After a discussion of the rules relating to barter transactions, the Q2 AOL deal was discussed. By this point in time, it was apparent that the acquisition by AOL was not going through, and they also realized that based on the comments made at the Audit Committee meeting in Q1 2001, any AOL deal would have to be booked on a net basis. Shew told everyone that as a result of raising the guidance and the fact that only net revenues could be booked, they would have to come up with a much larger number than last quarter. The discussion then turned to Cendant, and a discussion ensued, as alleged below, about not being able to document the back-end of any Cendant deals. At this point, both Shew and Giesecke reiterated that some type of deal would be done with Cendant, but a product had not yet been identified, and the back end could not be documented. So, amongst the three possible categories of sham revenues, AOL and Cendant deals were the only ones that could meet the shortfall. At this meeting in the sitting room at Cal Amigos, the top four executives at Homestore explicitly discussed how to illicitly buy revenues in order to meet the "plug" and how to manipulate the documentation to avoid detection by PWC.

352. At this point in time, May 7, 2001, Tafeen and Keller at AOL had already begun working on a deal to resolve this problem for Homestore. By May 18, DeSimone was in Shew's office in tears. He expressed deep concern about the deals that were being done and said further they should just miss their numbers as opposed to doing the deals. DeSimone said he did not want to do it anymore, and Shew tried to assure him that those decisions were being made at a higher level. Tafeen and Keller continued to work on the deal throughout this period of time. The Q2 AOL deal was structured very much like the Q1 deal. The Q2 AOL deal as agreed upon by Tafeen and Keller resulted in gross advertising revenues to

Homestore of $31.5 million. Tafeen and Keller agreed that AOL would keep $8 million of the “round tripped” funds as commissions.

353. By early June 2001, Shew learned the details of the Q2 AOL deal from Kalina who had prepared a schedule of how the deal would work. That schedule which was reviewed at various points by all members of senior management at Homestore explicitly showed the triangular nature of the deal. As of June 18, with the quarter rapidly coming to a close, the final revenue splits with AOL had not yet been determined. At this point, because of the need to book net revenues, Homestore wanted AOL’s commission to be as low as possible. At some point in June 2001, Keller was put on administrative leave by AOL due to his involvement in the PurchasePro deal. Despite the fact that Tafeen had already done the Q1 AOL deal with Keller, and had substantially agreed upon the Q2 deal before Keller’s being fired, Keller’s replacement attempted to unwind what Keller had done.

354. The executives at AOL who inherited the Q2 deal from Keller were Steven E. Rindner, Senior Vice President Business Affairs and Development and Joseph A. Ripp, the former Executive Vice President and Chief Financial Officer who was appointed AOL’s Vice Chairman on September 13, 2002. It became immediately apparent that Rindner and Ripp were trying to distance themselves from the deal because they were asking for documentation which they knew Homestore would not be able to provide. Tafeen was not able to get the deal done with the new AOL people, so Wolff asked Shew to get involved and make it happen. Both Tafeen and Wolff knew that the AOL documents had to be handled in a certain way to avoid detection, and Rindner and Ripp were pushing for the type of documentation that would create an paper trail on the hidden leg. Despite the fact that AOL attempted to put up barriers to keep the deal from going forward, AOL chose to do the Q2 deal anyway.

355. Neither Rindner nor Ripp ever said they were not going through with the deal, nor did they say that the deal as agreed upon by Keller was unauthorized. AOL had a financial interest in doing the deal despite the fact AOL believed that both their deals with Homestore presented problems: AOL had to protect its substantial investment in Homestore. AOL knew, from discussions between Keller and Tafeen that Homestore needed the Q2 deal to make its revenue target, and Tafeen took the position with Keller that AOL owed them.

356. Shew initially called Rindner and Ripp to determine what documentation AOL was requesting. Homestore was caught in a tough situation as providing the documentation could tip off PWC and not providing the documentation could cause AOL to walk, or trigger an inquiry into the lack of documentation. AOL was insisting on referencing the individual agreements with the third party vendors to each other under some type of master agreement. Homestore did not want a collective list that singled out these entities from others with whom it was doing business. In addition, AOL wanted to include a paragraph regarding Homestore's referral of business to AOL through the third party vendors. Either one would leave the type of paper trail that Homestore did not want. It was simply a deal killer for Homestore if AOL insisted that the list of referrals and the dollar amount of the referrals be listed in the documents. AOL asked for documentation of the hidden leg of the deal, obviously thinking that Homestore would rather not do the deal. In the end, compromises were reached on the documents that allowed the deal to be completed and provided sufficient protection to Homestore.

357. In a telephone conversation including Kalina and Stuart Kim, a member of the Homestore Legal department, Rindner and Ripp said that they would not agree to eliminate the list of referrals, but ultimately allowed Homestore to include many additional names which Homestore had no intention of doing business in order to provide cover for the actual referrals. The agreement

ultimately included a list of "Potential Referral Advertisers." But the list, as known to AOL and agreed upon by them, included a number of companies that were not under consideration as referrals. AOL specifically knew which companies on the list were be the source of the referral revenues. This compromise on the document and the inclusion of the "dummy" companies was discussed and known to Tafeen, Kalina, DeSimone and Shew as well as AOL.

xiii. <u>AOL's Expressed Concerns About Their Own Revenue Recognition</u>

358. During mid to late June 2001, Homestore and AOL had a series of discussions about AOL's ability to recognize revenue on their end of the deal. Shew, Kalina, Losh and Tafeen were working on this issue for Homestore, and and Ripp along with Wosanicker and Jaffe participated on the AOL side. Rindner and Ripp told Shew that the AOL internal credit department had concerns about the collectibility of the money from the third party vendors. This, in and of itself, was an acknowledgment by AOL of its knowledge of the "round trip" nature of the Q2 deal and was an express admission of the hidden leg. AOL contended that they needed to be reasonably assured that the money from the third party vendors was collectible so that they could recognize the revenues represented by their commission amount. There was also discussion about an additional $900,000 in revenue that could be recognized if AOL got specific confirmations from certain of the referral vendors. These communications took place both by phone and e-mail. Kalina had a schedule of the collectibility concerns which included cash constraints at the referral vendor, thin capitalization, or past slow pay experience with AOL. Shew had a number of meetings internally at Homestore with Tafeen and Kalina to try to resolve these collectibility issues for AOL. In order to resolve the problem, all three legs of the deal had to happen before the end of the quarter: Homestore had to get the money to the third party vendors, the third party vendors then had to agree to purchase advertising with AOL and pay for the same (in order

to avoid the collectibility issue), and AOL had to get Homestore its share after the commission so that Homestore did not have cash flow problems. Homestore went to extreme lengths to avoid the collectibility issue on AOL's behalf, including making the payments to the third party vendors so that AOL was assured they would get their money before the end of Q2. Homestore did not like the idea of paying the vendors in the quarter because under their accounting, Homestore would have to show that payment as a pre-paid asset which could raise questions with PWC about what they were getting for this pre-payment and when was it coming. Given the multiple communications between Homestore and AOL about where the money was coming from to pay for the AOL advertising, it is clear that despite their protestations, AOL was fully aware of the "round trip" nature of the Q2 deal and exactly how the money flowed through the referral vendors before they consummated the deal. With this knowledge, AOL, in fact, completed the Q2 deal with Homestore and knowingly participated in the Homestore scheme to defraud the investing public by creating illegal revenues.

xiv. Q2 Conference Call

359. On Friday, June 29, 2001, the last day of the second quarter, AOL had yet to receive confirming letters from a number of third party vendors about placing the required advertising. AOL was taking the position that it could not agree to pay Homestore until the letters were received. Tafeen told a number of the members of senior management at Homestore that AOL was going to "f***" them on the deal. Tafeen got Wolff to play the heavy, and he placed a call directly to Colburn to make sure the deal was going to happen. Wolff, Tafeen, Giesecke and Shew were panicked at Homestore and thought that some $20 million in promised revenues might not materialize in spite of all the efforts to make the deal palatable to Keller's replacements. The final confirming letter came in on the 29th, and Wolff's assistant, Tracy Stroup, placed a call to Colburn who was not available. She left a message to have Colburn call Wolff. Instead, Ripp called

back late in the evening on the 29th, and Wolff gathered Shew for the call who then told Giesecke that AOL was on the line and that AOL had not yet authorized most of the deal. Wolff, Tafeen and Shew got on the call and at some point Giesecke came in as well. Wolff was at his desk, and Tafeen paced around the room nervously. Wolff handled most of the call, but Tafeen would instruct that the call be put on mute in order to give his views. Tafeen was angry and felt AOL was going to renege on the deal. Wolff provided a summary of the Q2 deal from the Homestore perspective. He was abrupt and expressed his displeasure with the House & Home deal. DeSimone, Kalina and Tafeen put a schedule together for Wolff so that he could address the details of the deal. Wolff emphasized that the deal had been agreed to long ago by Keller, and he threatened litigation. Ripp and Rindner said that Keller was gone, but never denied Keller's authority to do the deal or that he had done the deal. Wolff responded that Keller was the authorized agent acting for AOL when he cut the deal, and suggested if there was any doubt about it, they should get Keller on the line. Tafeen said he had just talked to him and knew how to get a hold of him, but the AOL representatives declined the offer. There was a discussion about the size of the deal, the revenue recognition problems from AOL's end, and whether the Homestyle's deal should be included. Shew then addressed the fact that he had confirmed that money had already gone to certain of the third party vendors and AOL had received the payments for the advertising. The manner in which Shew explained how the money flowed left no doubt about the "round trip" nature of the subject transaction, and neither Rindner nor Ripp denied knowledge of the structure as described by Shew. Essentially, Shew told Rindner and Ripp in no uncertain terms that Homestore had fronted the money to the third party vendors in order to solve AOL's revenue recognition issues, that Homestore knew AOL had received the money, and based on the way the deal was structured, AOL had no reason not to pay Homestore and complete the deal. Shew actually had a schedule depicting confirmation of the flow of funds. It is beyond doubt that AOL knew the exact details of the deal and knowingly participated in Homestore's scheme to defraud the investing public.

360. When the call ended, Wolff, Giesecke, Tafeen and Shew sat and wondered whether AOL would actually perform. This was "do or die" time as it was the evening of the last day of the quarter, and Homestore had already paid out cash to start the "round trip" at the risk of not getting it back in time to boost their revenue figures. If the deal not completed by the end of the 29^{th}, Wall Street would tear them apart. AOL sent in their confirmation of the deal that evening after the call, and with full knowledge of the illicit nature of the Q2 deal, allowed Homestore to meet its target and keep Wall Street happy for another quarter. By doing this, as well as the Q1 2001 deal, AOL knowingly participated in a scheme to defraud the investing public and was the means by which Homestore was able to book illegal revenues in Q1 and Q2 2001.

2. Cendant

361. Cendant Corporation (NYSE:CD) is a provider of travel and real estate services. Its businesses provide a wide range of consumer and business services. The Real Estate Services segment franchises the real estate brokerage businesses of the Century 21, Coldwell Banker, Coldwell Banker Commercial and ERA brands. The Hospitality segment operates the Days Inn, Ramada, Super 8 Motel, Howard Johnson, Wingate Inn, Knights Inn, Travelodge, Villager Lodge, Village Premier, Hearthside by Villager and AmeriHost Inn. The Vehicle Services segment operates and franchises Avis, the Company's car rental business. The Travel Distribution segment provides global distribution and computer reservation services to airlines, hotels, car rental companies and other travel suppliers. The Financial Services segment provides enhancement packages to financial institutions.

362. The business alliance between Cendant and Homestore began as early as 1998 when Homestore paid Cendant $13-15 million for an agreement not to

compete. Wolff, the CEO of Homestore, viewed a relationship between Cendant and Homestore as critical to Homestore's success because portions of Cendant's business empire directly competed with Homestore.

363. According to a October 22, 1999 Homestore Press Release, the alliance agreements provided for: (i) exclusive endorsement by Cendant of Homstore.com's web page design, hosting and maintenance services to the brokers and sales associates of Cendant's Century 21, Coldwell Banker and ERA residential real estate franchise systems; (ii) active assistance by Cendant of Homestore.com in marketing such web-based products and services to the brokers and sales associates and (iii) granting the Exclusive third-party license to use the approximately 400,000 electronic listings of the three Cendant brands to Homestore.com, along with Cendant's promotion of Homestore.com as a leading online distributor of those listings." Shortly thereafter, the relationship soured and litigation ensued. In October 1999, according to Homestore's October 22, 1999 Press Release, the companies settled their differences and reaffirmed their previous alliance agreements. "As part of the settlement, Cendant will receive 250,000 shares of Homestore common stock and will take various actions to reaffirm its alliance agreements with Homestore.com," the Press Release stated.

i. **Cendant Wants to Keep Move.com Off its Income Statement**

364. In or about January 2000, Cendant and the National Association of Realtors launched Move.com, an Internet web site to offer relocation and other real estate services to consumers. By early 2000, Cendant realized that Move.com was not going to be a profitable company and it did not want Move.com included on its profit or loss statement, though it wanted to maintain this type of Internet site since it was complementary to its real estate business. Cendant first tried to carve out the Move.com stock by making it a "tracking stock." On February 9, 2000, Cendant filed a Proxy Statement, Schedule 14A with the SEC regarding its

intent to make Move.com a tracking stock. The Proxy Statement explained to the shareholders that tracking stock:

> [S]ometimes referred to as "alphabet stock," "letter stock," or "targeted stock," is a common stock that represents an ownership interest in the corporation that issues it but it is designed to reflect, or track, the performance of a specified group of the corporation's assets or business. It is therefore said to track the performance of those assets or businesses. We propose creating a new series of tracking stock, to be designated as Move.com Stock, and reclassifying our existing common stock into a new series of common stock to be designated as CD stock.

365. On February 14, 2000, Cendant issued a Press Release announcing that it had filed a Registration Statement with the SEC relating to the initial public offering of Move.com tracking stock. On March 21, 2000, Cendant announced, through a Press Release, that its shareholders had voted to approve the Move.com tracking stock. Cendant, however, never issued tracking stock in Move.com; instead in June 6, 2000 Press Release, it announced it had postponed the public offering: "Citing current market conditions, Cendant Corporation (NYSE: CD) announced today that it has postponed the public offering of Move.com Group tracking stock. Cendant was, however, in April of 2000 able to sell about 1.5 million shares of Move.com in a public placement to Liberty Digital in exchange for Cendant and Liberty Digital's agreements "to use good faith efforts to enter into mutually acceptable agreements relating to the development of real estate-related programming for Liberty Digital's interactive television initiatives based on Move.com Group's Web content." April 4, 2000 Cendant Press Release, "Liberty Digital, Chatham, Street Holdings and NRT Take Equity Stake in Cendant's Move.com; Cendant Stock Reclassified." The same Press Release reported that Chatham Street Holdings, LLC exercised a contractual right to purchase about 1.5 million shares of Move.com in a private placement and NRT Incorporated also agreed to purchase about 318,000 shares in a private placement.

366. Since it was unable to issue Move.com as a tracking stock and still wishing to keep Move.com's losses from its revenue statements, Cendant

Corporation gave revenue figures, excluding Move.com losses. For example, in Cendant's Report of First Quarter 2000 results, it announced: "First quarter results and other recent activities include: [¶] ● Adjusted earning per share, excluding Move.com Group, were up 24% to $0.26 versus $0.21." As to Move.com, Cendant reported:

> Move.com group recorded revenues of $11 million as compared to $3 million in the prior year period. Adjusted EBITDA decreased $26 million to a loss of $26 million in 2000. These results reflect increased investment in marketing and development of the new real estate services Internet portal, which was launched in January. The Company expects Move.com Group will continue to report losses in the foreseeable future resulting from continuing investment in the growth of the business.

367. In its Statement of Financial Results of Operations, Cendant separated the Cendant revenues and expenses from the Move.com revenues and expenses.

368. For Cendant's third Quarter 2000 Results, Cendant, once again, separated the Cendant revenues and expenses from the Move.com revenues and expenses. Regarding Move.com, Cendant reported:

> Move.com revenues tripled because of higher sponsorship revenues made possible by the first quarter 2000 launch of our Internet real estate services portal, move.com. The company expects Move.com will continue to report losses for the foreseeable future resulting from continuing investment in the growth of the business.

ii. <u>Homestore Agrees to Acquire Move.com in October 2000</u>

On October 27, 2000, Homestore and Cendant announced, in a joint Press Release, that Homestore had signed an agreement on October 26, 2002 to acquire Move.com from Cendant Corporation. The Press Release announcing the deal stated:

> The transaction combines the Internet's two leading Web sites in the home and real estate category under the Homestore.com brand. . . . The transaction also ensures that Homestore.com's Web site REALTOR.com will have exclusive 40-year access to the aggregated listings of Cendant Corporation's Century 21, Coldwell Banker and ERA national real estate franchises and includes an agreement by

Cendant to purchase Homestore.com's technology and web-based marketing products and vertical ASP solutions.

In addition, Cendant will invest in Homestore.com's development of the Realtors Electronic Transaction Platform (eRealtor.com, the official real estate transaction platform of the National Association of Realtors) helping to unite industry participation behind Homestore.com's technology solution for online real estate transactions. . . .

Under terms of a definitive agreement signed yesterday, Homestore.com, Inc. Will acquire move.com in an all-stock transaction totaling approximately 26.3 million shares of the company's common stock. Based on yesterday's closing price of $28.953 per share, the transaction is valued at approximately $761 million.

"We are committed to building the most vibrant and comprehensive online home and real estate marketplace possible at Homestore.com for the benefit of all of our consumers and professional customers," said Stuart Wolff, Homestore.com's chairman and chief executive officer. "With this transaction, we're increasing choices for consumers nationwide while continuing to put the real estate professional center stage. This is a giant step forward," Wolff said Cendant's chairman, president and chief executive officer, Henry R. Silverman stated: "Homestore.com has done an outstanding job establishing itself as the leading Internet real estate destination, and we are very pleased to align our expanding New Economy efforts with them. The benefit of this transaction is twofold: first, it provides the expertise of an Internet industry leader to enhance our real estate brands' Web sites and technology to benefit franchisees and consumers. Furthermore, it benefits our shareholders based on their investment in move.com and demonstrates the successful execution of Cendant Internet Group's strategy."

Chairman and CEO of Cendant's Real Estate Division, Richard A. Smith said: "This business combination is expected to enhance Cendant's off-line real estate businesses and franchise systems. Licensees and consumers will clearly benefit from this transaction through compelling new e-commerce services, as well as joint marketing and promotional opportunities." "We are most excited about this latest acquisition because it forges together the expertise, resources and talents of the largest real estate franchises and creates, on one stage, a platform for real estate professionals to provide consumers efficient services in today's complex marketplace," said NAR President Dennis R. Cronk.

* * *

Homestore.com said it expects the acquisition, which brings with it new revenue streams and cost synergies, to be accretive to the company's fiscal 2001 earnings. Longer term, the company anticipates a variety of synergistic opportunities resulting from the merged assets, as well as increasing financial benefits from the economies of scale the transaction will make possible.

Homestore.com's acquisition of move.com is subject to a number of customary conditions including, among other things, the approval of Homestore.com, Inc.'s shareholders, and regulatory review under the Hart Scott Rodino Antitrust Improvements Act. The transaction is currently under review by the antitrust division of the Department of Justice. Upon closing, Cendant Corporation will be entitled to name one director to Homestore.com's board, which currently has six members. Cendant also will be restricted in its ability to sell its Homestore.com shares and has agreed to vote its shares on all corporate matters in proportion to the voting decisions of all other shareholders. In addition, Cendant has agreed to a ten-year standstill agreement that, under most conditions, prohibits the company from acquiring additional Homestore.com common shares. Homestore.com and Cendant Corporation said they expect to complete the transaction within the next six months.

The transaction includes the following key elements:

Homestore.com will integrate move.com and its related assets including Rent Net, a leading residential rental listing and apartment finder service on the Internet, into the Homestore.com network, combining two of the most popular and traffic-generating real estate destinations on the Web today. The transaction does not include National Home Connections (NHC) or Metro Rent, which will be retained by Cendant.

Additionally, for 40 years, Homestore.com will acquire the exclusive rights to the aggregated online residential real estate listings of Cendant's Century 21, Coldwell Banker and ERA national real estate brokerage franchises, which also will continue to be featured on those brands' respective Internet sites. Cendant and Homestore.com, Inc. will also enter into an agreement to develop Internet-based technology and tools that will provide even greater choices for real estate brokers and agents. Cendant's real estate franchisees are currently involved in approximately 25 percent of U.S. residential real estate transactions and annually assist more than 1.5 million buyers and sellers of single family homes.

Cendant will become an equity investor in Homestore.com's technology project to develop an online real estate transaction platform (eRealtor.com, the official real estate transaction platform of NAR), joining current participants including the National Association of Realtors, Fannie Mae, GMAC Real Estate, GMAC Mortgage and VeriSign. Prudential Real Estate Network and RE/MAX also endorse the transaction platform. With the participation of Cendant's three national franchise organizations, Homestore.com will unify six of the largest U.S. national residential real estate franchises behind Homestore.com's industry standard for online real estate transactions. Cendant Mobility, Cendant's relocation company and NRT Incorporated, Cendant's largest real estate franchisee, also have agreed to use the transaction platform exclusively for a period of three years. These two organizations accounted for more than 400,000 transactions last year. Homestore.com will also have the ability to host the Internet sites of Cendant's three real estate brands.

> Cendant's three national real estate franchises have committed to develop a series of cross-marketing and advertising programs with Homestore.com's family of Web sites (including REALTOR.com), including an agreement to include the REALTOR.comURL in a minimum of 50 percent of the three franchises' offline advertising campaigns.
>
> Finally, Homestore.com will acquire all rights to Welcome Wagon, the widely recognized direct marketing program that introduces participating neighborhood retailers and their services to new homeowners. Homestore.com plans to leverage the brand equity of the 72-year-old company to expand and enrich Homestore.com's local retail e-commerce business strategies. Welcome Wagon represents a network of more than 35,000 merchants and reaches 1.8 million new homeowners annually.

369. On October 27, 2000, Cendant Corporation hosted an Investor Conference Call and Webcast to discuss the acquisition.

370. On November 3, 2000, Cendant filed with the SEC an 8-K disclosing the Agreement and Plan of Reorganization of Homestore acquiring Move.com. The 8-K attached the companies' joint Press Release.

371. Wolff recognized very early on that in order for Homestore to succeed it would have to obtain an exclusive listing arrangement with a massive real estate conglomerate such as Cendant. Cendant carries approximately 30% of the total real estate listings in the United States. On its part, Cendant agreed to fund its Real Estate Technology Trust ("RETT") with $95 million. Cendant was the exclusive source of funding for RETT. In turn, RETT would enter into a series of commercial agreements with Homestore worth $80 million over the following two years.

372. In its filing with the SEC, Cendant stated that the purpose of establishing RETT was to acquire technology on behalf of Cendant. CEO of Cendant Henry Silverman later publicly stated that the entire $95 million was intended for the purchase of products from Homestore. Although established as a separate entity, one of Plaintiff's confidential sources states that any deals with RETT were initiated and carried out by contacting Cendant directly. Contacts at

Cendant were Richard Smith, a voting member of Homestore's Board of Directors, Dave Weaving and Eric Bock.

373. According to Plaintiff's confidential source, Homestore was concerned that this deal would appear to be a stock for cash swap due to questionable valuation. Therefore, PWC was consulted by Homestore in order to establish the value of the transaction. Because PWC was also concerned that this deal looked like a stock for cash deal, PWC referred Homestore to the appraisal firm Houlihan, Lokey, Howard & Zukin. Lee Shepard of the San Francisco office was the person in charge of Houlihan, Lokey, Howard & Zukin's valuation. Upon Houlihan, Lokey, Howard & Zukin's valuation, PWC signed off on Homestore's acquisition of Move.com.

iii. Cendant Continues to Report Financial Information Excluding Move.com

374. Cendant continued to report financial information, excluding Move.com. In a November 13, 2000 Press Release, it stated that excluding Move.com, fourth quarter adjusted earnings per share met Wall Street estimates:

> The Company will reiterate that its expectations for fourth quarter 2000 adjusted earnings per share are in line with published Wall Street estimates. Adjusting for the reclassification of the Individual Membership segment as a discontinued operation, the Company expects fourth quarter 2000 adjusted earnings per share from continuing operations and excluding Move.com to be $0.18 and full year 2000 adjusted earnings per share from continuing operations and excluding Move.com to be $0.90.
>
> The Company also will announce that preliminary projections, including the benefit of the pending acquisitions of Avis Group and Fairfield Communities, for adjusted earnings per share from continuing operations and excluding Move.com are $0.91 in 2001, $1.06 in 2002 and $1.21 in 2003. The growth rate in 2001 will be negatively affected by the incremental interest from the common stock class action litigation settlement.

375. On December 20, 2000, Cendant once again "reiterated that it projects adjusted earnings per share from continuing operations, including the benefit of the pending acquisitions of Avis Group and Fairfield Communities and excluding Move.com's operating results and the impact of the sale to

Homestore.com, to be $0.91 in 2001." The Press Release also stated: "The Company announced the following financial projections from continuing operations, excluding the results of Move.com, for first quarter 2001: . . . ."

iv. Top Producer Deal (Q4 2000)

376. On June 12, 2000, Homestore issued a press release announcing that its acquisition of Top Producer Systems, Inc. ("Top Producer"). Homestore acquired Top Producer for approximately $24.2 million in Homestore common stock and cash. As a part of the deal, the founding shareholders of Top Producer were entitled to receive up to $16.2 million over the following four years if certain performance targets were met.

377. During the same quarter that Homestore and Cendant were touting the impending acquisition of Move.com by Homestore, the two companies entered into an improper transaction. In the fourth quarter of Fiscal Year 2000, Cendant purchased $5 million of a Top Producer product called Top Presenter. According to Plaintiff's confidential sources, this purchase was made in the last week of the quarter and was meant to help Homestore make its numbers and boost Homestore's common stock price for the benefit of Cendant which stood to gain a 20% interest in Homestore upon completion of Homestore's Move.com acquisition. As a direct result of this $5 million purchase, Cendant's obligation to provide $80 million in revenue under the Move.com acquisition agreement to Homestore was reduced to $75 million.

378. Homestore immediately recorded this deal as revenue, but according to Plaintiff's confidential sources Homestore's act of immediately recording this revenue was considered highly questionable because under SOP 97-2, the software required customization after the quarter was completed. SOP 97-2 would not allow recording this deal as revenue until the customization was complete. The product could not be used or shipped to Cendant until completion of the customization. Nonetheless, the deal was immediately recorded as revenue. This

was openly disclosed to PWC in the first quarter of 2001, and PWC allowed the transaction to be booked because the $100,000 to $200,000 customization was deemed by PWC to be immaterial.

v. **Homestore's Acquisition of Move.com Is Completed**

379. On January 11, 2001, Homestore issued a Press Release announcing that "a majority of its shareholders approved the issuance of additional shares of common stock in conjunction with the company's proposed acquisition of Cendant Corporation's real state portal, Move.com. The company expects to issue approximately 26.3 million shares of stock upon closing. The transaction is expected to close as soon as practicable following regulatory review under the Hart Scott Rodino Antitrust Improvements Act."

380. In February 2001, the Department of Justice completed its investigation of Homestore's acquisition of Move.com. As a result of Homestore's acquisition of Move.com, Cendant obtained a 20% ownership of Homestore and two positions on Homestore's Board of Directors. Richard Smith, Chairman and CEO of Cendant's Real Estate Group became a voting member of Homestore's Board of Directors and Sam Katz, CEO of Cendant's Internet Group became a non-voting member of Homestore's Board of Directors. This relationship became crucial to Homestore's ability to meet or exceed its quarterly revenue projections. In fact, Plaintiff's confidential sources recall that Tafeen privately described Cendant as a sure source of revenue in the event that Homestore needed last minute revenues at the end of a quarter to "make the bogie."

381. According to Plaintiff's confidential sources, this acquisition deal would never have been carried out if the $80 million in guaranteed revenue from RETT were not part of the deal. Moreover, Shew, Wolff, Tafeen, and Giescke were fully aware of the nature of the merger and the related component

transactions. Each of these deals were simultaneous and contingent upon the other deals.

vi. The iPIX Transaction

382. In February 2001, the acquisition of Move.com was approved and Cendant fulfilled it's obligation to fund RETT with $95 million. In order to avoid a negative reaction on Wall Street, Cendant classified the $95 million payment as a one time non-recurring expense.

383. According to Plaintiff's confidential sources, a divergence of opinion between Homestore's auditor, PWC, and Cendant's auditor, Deloitte & Touche, developed in this quarter regarding how to account for deals between Homestore and RETT. PWC determined that these transactions should be recorded as related party transactions. Deloitte & Touche disagreed and allowed transactions between RETT and Homestore to be recorded as though they were not related party transactions. Initially, PWC gave into Cendant's views on the subject.

384. During the first quarter of fiscal year 2001, Homestore acquired iPIX. Giesecke was in charge of integrating iPIX operations with Homestore. According to Plaintiff's confidential sources, after Homestore's acquisition of iPIX was complete, Homestore once again began a desperate search for additional revenues to meet the earnings expectations of Wall Street.

385. To meet those expectations, Homestore turned to Cendant. Tafeen knew that Cendant had funded RETT with $95 million and that only $80 million of that funding was committed to Homestore. Thus, Tafeen turned to Smith for the remaining $15 million. According to Plaintiff's confidential sources, Cendant agreed to purchase $15 million worth of iPIX virtual tours from Homestore, but only if Homestore would agree to purchase $15 million in products from Cendant at a later date. Tafeen discussed this with Shew and according to Plaintiff's confidential sources, Shew informed Tafeen that Tafeen could not sign the "give-back" contract with Cendant or PWC would not allow Homestore to recognize the

$15 million as revenue. Shew advised Tafeen that he needed separation between the two deals, and that the contract could only be signed on the "give back" after the first of the year, 2002. Tafeen executed the deal and signed the "give-back" contract at the same time and hid the contract.

386. Several "red-flags" were obvious in this transaction. First, according to Plaintiff's confidential sources, Cendant understood that these virtual tours were full-service. However, Homestore booked the tours as self-service in order to be able to record the revenue immediately. Cendant never intended to use self-service tours, but characterized them as such so Homestore could book the revenue. Second, according to Plaintiff's confidential source, this transaction raised concerns for DeSimone and Kalina because Cendant's purchase of $15 million in virtual tours was grossly excessive. More specifically, $15 million in full-service virtual tours is more than any purchaser could use in 20 years and if PWC looked at the sale PWC would object to the valuation of the virtual tours. If the tours were full-service, they would be booked as revenue only as they were used since there would be further work to implement them. If they were deemed self-service, the revenue could be booked immediately. Accordingly, Homestore changed the virtual tours from full-service to self-service, so that the revenue could be booked immediately.

387. For its part, Cendant was now an owner of Homestore and was concerned that the value of Homestore's stock would drop if Homestore failed to meet its revenue projections. Because of the massive investment of Cendant in Homestore, Cendant wanted to prop up the value of Homestore common stock. By the third quarter of fiscal year 2001, Homestore was increasingly desperate for revenue. Wolff, Tafeen, Giescke and Shew held regular meetings on July 23-26, 2001 to discuss how to meet their revenue projections or "plug" as they referred to it on their R&O sheets. Wolff, Tafeen, Giescke and Shew were keenly aware that

they were facing a $50 million revenue shortfall in the third quarter of 2001 and even contemplated a convertible bond offering to meet their projected shortfall.

388. On October 3, 2001, Homestore announced that it would miss its revenue projections. With this announcement the Audit Committee began to ask questions of the CFO and Finance Department. As late as November 5, 2001, Shew and David Weaving of Cendant conducted a telephone call to discuss potential revenue generating deals with Cendant. Shew was surprised when Weaving instead requested payment due under prior agreements signed by Tafeen. Shew asked that Weaving fax him a copy of the contracts and Weaving did fax the contracts to him. The deals were called Preferred Alliance Agreements. According to Plaintiff's confidential sources, there were four Preferred Alliance Agreements. Although the effective dates of the agreements was 2002, the facsimile transmission demonstrates that the Preferred Alliance Agreements were simultaneous regardless of the delay in contract performance dates.

3. L90 a/k/a Max Worldwide

389. Defendant L90 knowingly participated in Homestore's scheme to defraud the investing public and members of the Class by entering into improper transactions with Homestore in the second and third quarters if fiscal year 2001.

390. According to Plaintiff's confidential sources, during the second quarter of 2001, Thomas Vo, an employee working for Tafeen in the Business Development group who was a former employee of L90 acted as a link between Homestore and L90.

391. In the second quarter of 2001, Homestore spent $4 million in order to obtain $3.74 million in revenues in a triangular deal with L90. Similarly, in the third quarter of 2001, Homestore spent $5.65 million in order to obtain an equivalent amount in revenue. Plaintiff's confidential sources have personal knowledge of these L90 deals.

392. Tafeen, Shew, DeSimone and Kalina knew the details of these transactions. In the Q3 audit process, PWC again asked questions regarding the L90 transaction. PWC asked Shew to describe who L90 was, what their business did and how the transaction was booked. Shew was caught off guard, and did not know the answers. At that time, Shew speculated that L90 was an advertising agent and that L90 netted the transaction.

393. PWC further questioned Shew when Withey confronted Shew with L90's balance sheet and cash flow statement, and asked why L90 would spend such a large amount relative to their total worth in advertising on Homestore. Shew had no reply for Withey, and Withey asked Shew to follow up with L90 and get a confirmation of the deal.

394. Shew did not follow up with L90. PWC persisted, and asked Adam Richards, Knudsen or Jason Boling of Homestore to get the L90 confirmation of the third quarter deal. Shew told Richards to get the confirmation signed by L90. As the earnings release time approached and passed, PWC did not insist on obtaining the L90 confirmation.

395. Later, Merrill went into Shew’s office and told him that Mark Roah, founder of L90, had asked for $50,000- $150,000 to sign the confirmation letter. Merrill then described how Roah allegedly was breaking laws of a publicly traded company. Merrill told Shew that Homestore would not pay.

396. After November 1, Richards, Knudsen or Boling informed Shew that PWC would not sign Homestore’s 10Q without a confirmation letter from L90. Because the earnings had already been released, the confirmation of this deal was necessary so that Homestore would not have to restate its third quarter financials. Shew told Giesecke of these events, and Giesecke said that Tafeen should get the confirmation signed. At that point, Tafeen had already moved to Florida. Shew called Tafeen in Florida and asked him to get the confirmation letter signed, and explained the importance of the confirmation as the earnings had already been

released. Tafeen's response was that it was not his job anymore, and that Merrill or Vo should take care of it.

397. On or about November 13, 2001, at 9:00 a.m., Merrill, Shew and Vo attended a conference call in Merrill's office with Roah regarding the L90 confirmation letter. Giesecke attended portions of the call. As the call was occurring, Shew reviewed a presentation that Merrill had drafted entitled, "Why are we here?" This presentation was to be made to the board in an attempt to explain how Homestore had not seen the revenue shortfall coming. Roah told Merrill and Shew that he did not want the $50,000-$100,000 that he had previously asked for in exchange for a signed confirmation letter. Roah told the Homestore attendees that he, personally, wanted some kind of continuing business relationship with Homestore. Roah wanted to do legitimate deals with Homestore, but not through L90. Roah still did not want to sign the confirmation letter, as he feared that he would be personally liable. Roah told Homestore that L90's general counsel advised him not to sign the confirmation.

398. At that point, Shew explained to Roah the implications for Homestore of not having the confirmation signed; that Homestore would have to restate its third quarter financials, and that L90 might be implicated in the restatements. Shew also tried to convince Roah that he might not be personally liable, depending on the interpretation of the text of the confirmation letter. The conference call ended with Roah undecided on whether or not he would sign the confirmation letter.

399. After the call, Merrill, Shew and Giesecke discussed what might happen to the company if a restatement was on the horizon. At 10:30 p.m. on or about November 13, 2001, Shew received a phone call at home from Roah in which Roah stated that he would sign the confirmation.

400. On or about the morning of November 14, the day that Homestore had to file its 10Q, Merrill, Shew and Giesecke met once again to discuss the

events of the previous day. Now that they had the confirmation, Shew expressed that he was uncomfortable signing the 10Q, which they all knew to be false. Merrill volunteered to discuss this issue with Wolff, which seemed odd to Shew and Giesecke. Merrill and Wolff left the building to discuss the issue, and they circled the parking lot as they spoke.

401. In that same conversation between Merrill, Shew and Giesecke, Merrill said that Barbara Alexander, a member of Homestore's Audit Committee and long-time friend of Merrill's, asked him "point blank" if Homestore was buying its revenues. Merrill did not know how to respond to Alexander's question, as he had knowledge of the AOL, Cendant and L90 deals. Giesecke, sympathetic to Merrill's predicament, responded by saying, "You're f***ed, dude."

402. In March 2002, L90 revealed that federal investigators were questioning it concerning past reporting of revenues, specifically with regard to transactions with Homestore. The SEC has subpoenaed records and at least one member of L90's Board of Directors related to two barter advertising transactions that occurred with Homestore in the second and third quarters of 2001.

403. The SEC is investigating allegations of wire transfers, that L90 and Homestore recorded as revenue from advertising services, between L90, Homestore and Hi-Speed Media. Those purported revenues were barter transactions and were improperly accounted for as revenue. In a May 16, 2002 Wall Street Journal Online front-page article entitled, "SEC Broadens Its Investigation into Revenue-Boosting Tricks," the Journal reported that "SEC officials are investigating L90 Inc., Homestore and Hi-Speed Media for wire transfers that moved money among the three companies, in transactions that became increasingly complex and made a paper trail hard to follow." Former Directors of Business and Development confirmed that these types of transactions occurred at Homestore with the knowledge of all Defendants.

404. L90 issued a May 6, 2002 press release which stated that it was conducting an internal investigation into "groups of transactions in 2000 and 2001 involving multiple vendors and service providers . . . (that) appear to represent barter transactions. The results will be restated because these transactions do not appear to meet the criteria for revenue recognition under generally accepted accounting principles." In conjunction with its internal investigation, L90 reduced its 2000 and 2001 revenue by $8.3 million (10%), reclassifying $250,000 of revenue as "other income."

4. Dorado

405. Beginning in 2000, Defendant Homestore and Dorado entered into a fraudulent reciprocal transaction. According to Plaintiff's confidential sources, Homestore dealt with an employee of Dorado who knew and agreed to the fraudulent nature of the transaction. In the first leg of the transaction, Homestore agreed to provide website advertising to Dorado and also purchased its stock with cash. In the second leg or reciprocal component of this transaction, Dorado agreed to recycle the cash paid by Homestore back to Homestore as payment for Homestore's web site advertising and provided stock in its company to Homestore. Dorado knew that in order to obtain sufficient market value to go public, it would have to continue to increase its revenues and this transaction allowed Dorado to appear more successful than it actually was. By knowingly accepting the money as a *quid pro quo* and because of the nature of the transaction which resulted in neither company receiving cash but yet allowed both companies to tout to the market increased business, Dorado also knew that it was engaging in an improper transaction.

5. Bank of America

406. Bank of America is a bank holding company with revenues in 2001 of $35 billion and earnings of $521 million. In the fourth quarter of 2000, Bank of America and Homestore entered into a fraudulent round tripping transaction.

Homestore desperately needed to make the "bogie" for that quarter. Bank of America was most interested in acquiring the Homestore shares and even submitted a written presentation to Tafeen demonstrating how a public announcement of a deal with Bank of America would increase the price of Homestore's shares, complete with projections.

407. Tafeen announced to the Individual Homestore Defendants and others, that he had a deal with Bank of America in which $4.5 million of the total amount would be advanced to Homestore to help make the "bogie." Homestore was to give Bank of America 600,000 unregistered shares of its stock, web site design and development, and advertising for Bank of America on the Homestore web site.

408. Bank of America agreed to pay $15 million for the web site design. But the deal was structured over two quarters and the $4.5 million advance was made contingent upon the completion of the remainder of the deal. Both Withey at PWC and Homestore's own board of directors expressed significant concerns about the propriety of allowing Homestore to recognize the $4.5 million advance as revenue for the fourth quarter of 2000 due to the reciprocal nature of the transaction and the inclusion of the stock. Nonetheless, PWC allowed Homestore to recognize the $4.5 million as revenue, despite the fact that the broader, contingent deal had not been completed.

6. <u>Third Party Vendors Engaged In Reciprocal Fraudulent Transactions With Homestore</u>

409. Each of the Defendants, who are third party vendors and listed below, were direct participants in a scheme to deceive, manipulate, and/or defraud the market, by willfully making statements or omissions that were known or believed to be false or misleading at the time and under the circumstances made, to artificially alter the price of Homestore's stock in order to induce the sale or purchase of Homestore's stock.

i. Akonix

410. Beginning in 2000, Defendant Homestore and Akonix entered into a fraudulent reciprocal transaction. According to Plaintiff's confidential source, Homestore dealt with an employee of Akonix who knew and agreed to the fraudulent nature of the transaction. In the first leg of the transaction, Homestore paid cash to Akonix in exchange for advertising and other services. In the second leg or reciprocal component of the transaction, Akonix recycled the cash paid by Homestore back to Homestore as payment for Homestore's purported advertising and other services. Like other Internet companies, Akonix knew that in order to obtain sufficient market value to go public, it would have to continue to increase its revenues and this transaction allowed Akonix to appear more successful than it actually was. By knowingly accepting the money as a *quid pro quo* and because the nature of the transaction which resulted neither company receiving cash but yet allowed both companies to tout to the market increased business, Akonix also knew that it was engaging in an improper transaction.

ii. CityRealty.com, Inc.

411. Beginning in 2000, Defendant Homestore and CityRealty entered into a fraudulent reciprocal transaction. According to Plaintiff's confidential sources, Homestore dealt with an employee of CityRealty who knew and agreed to the fraudulent nature of the transaction. In the first leg of the transaction, Homestore paid cash to CityRealty in exchange for advertising and other services. In the second leg or reciprocal component of the transaction, CityRealty recycled the cash paid by Homestore back to Homestore as payment for Homestore's purported advertising and other services. CityRealty knew that in order to obtain sufficient market value to go public, it would have to continue to increase its revenues and this transaction allowed CityRealty to appear more successful than it actually was. By knowingly accepting the money as a *quid pro quo* and because the nature of the transaction which resulted neither company receiving cash but yet allowed

both companies to tout to the market increased business, City Realty also knew that it was engaging in an improper transaction.

iii. Classmates Online, Inc.

412. Beginning in 2000, Defendant Homestore and Classmates entered into fraudulent reciprocal transactions. According to Plaintiff's confidential sources, Homestore dealt with an employee of Classmates who knew and agreed to the fraudulent nature of the transaction. In the first leg of the 2000 transaction, Homestore paid cash to Classmates in exchange for advertising and other services. In the second leg or reciprocal component of the transaction, Classmates recycled the cash paid by Homestore back to Homestore as payment for Homestore's purported advertising and other services.

413. The second transaction was a triangular transaction between Classmates, Homestore and AOL which occurred during the first two quarters of 2001. In the first leg, Homestore paid cash to Classmates for sham services, technology, advertising or content. The deal was designed to look as if it was a stand alone deal. In the second leg of the transaction, AOL paid cash to Homestore for advertising placed by Homestore on AOL. The third leg was the source of the money and the *quid pro quo* for the deal. Classmates bought advertising with AOL and used the Homestore money which was being "roundtripped" back to them.

414. Like other Internet companies, Classmates knew that in order to obtain sufficient market value to go public, it would have to continue to increase its revenues and this transaction allowed Classmates to appear more successful than it actually was. By knowingly accepting the money as a *quid pro quo* and because the nature of the transaction which resulted neither company receiving cash but yet allowed both companies to tout to the market increased business, Classmates also knew that it was engaging in an improper transaction.

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iv. CornerHardware.com

415. Beginning in 2000, Defendant Homestore and CornerHardware entered into a fraudulent reciprocal transaction. According to Plaintiff's confidential sources, Homestore dealt with an employee of CornerHardware who knew and agreed to the fraudulent nature of the transaction. In the first leg of the transaction, Homestore agreed to provide website advertising to CornerHardware and also purchased its stock with cash. In the second leg or reciprocal component of this transaction, CornerHardware agreed to recycle the cash paid by Homestore back to Homestore as payment for Homestore's web site advertising and provided stock in its company to Homestore. CornerHardware knew that in order to obtain sufficient market value to go public, it would have to continue to increase its revenues and this transaction allowed CornerHardware to appear more successful than it actually was. By knowingly accepting the money as a *quid pro quo* and because the nature of the transaction which resulted neither company receiving cash but yet allowed both companies to tout to the market increased business, Corner Hardware also knew that it was engaging in an improper transaction.

v. GlobeXplorer, Inc.

416. Beginning in the last quarter of 2000/first quarter 2001, Defendants Homestore, AOL and GlobeXplorer entered into a fraudulent triangular transaction. According to Plaintiff's confidential sources, Homestore dealt with an employee of GlobeXplorer who knew and agreed to the fraudulent nature of the transaction and received money off the top from the deal. In the first leg, Homestore paid cash to GlobeXplorer for sham services, technology, advertising or content. The deal was designed to look as if it was a stand alone deal. In the second leg of the transaction, AOL paid cash to Homestore for advertising placed by Homestore on AOL. The third leg was the source of the money and the *quid pro quo* for the deal. GlobeXplorer bought advertising with AOL and used the Homestore money which was being "roundtripped" back to them. GlobeXplorer

knew that in order to obtain sufficient market value to go public, it would have to continue to increase its revenues and this transaction allowed GlobeXplorer to appear more successful than it actually was. By knowingly accepting the money as a *quid pro quo* and because the nature of the transaction which resulted neither company receiving cash but yet allowed both companies to tout to the market increased business, GlobeXploer also knew that it was engaging in an improper transaction. Homestore thought about not going through with the deal. According to Plaintiff's confidential sources, on or about February 13, 2000 at the Robertson Stephens Inc. investor's conference in San Francisco, GlobeXplorer threatened to publicly expose the improper deal if it was not consummated. To avoid the threat of exposure, Homestore consummated the deal.

vi. Internet Pictures Corp./iPix

417. During fiscal year 2001, Defendant Homestore and iPix entered into a fraudulent reciprocal transaction. According to Plaintiff's confidential sources, Homestore dealt with an employee of iPix who knew and agreed to the fraudulent nature of the transaction. In the first leg of the transaction, Homestore paid $12 million to iPix for assets, including technology and contracts. The deal was announced on January 16, 2001 and was hailed by Robert Stephens. In the second leg of the transaction, iPix bought advertising and used the Homestore money which was "roundtripped" back to Homestore. In entering into these deals, iPix knew that in order to obtain maintain sufficient market value to maintain and increase its stock price, it would have to continue to increase its revenues and this transaction allowed iPix to appear more successful than it actually was. By knowingly accepting the money as a *quid pro quo* and because the nature of the transaction which resulted neither company receiving cash but yet allowed both companies to tout to the market increased business, iPix Pictures also knew that it was engaging in an improper transaction.

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vii. InvestorPlus/IPG

418. Beginning in 2000, Defendant Homestore and Investor Plus entered into fraudulent reciprocal transactions. According to Plaintiff's confidential sources, Homestore dealt with an employee of Investor Plus who knew and agreed to the fraudulent nature of the transaction.

419. In the first leg of the 2000 transaction, Homestore agreed to provide website advertising to Investor Plus and also purchased its stock with cash. In the second leg or reciprocal component of this transaction, Investor Plus agreed to recycle the cash paid by Homestore back to Homestore as payment for Homestore's web site advertising and provided stock in its company to Homestore.

420. In the second transaction, which occurred in the second quarter of 2001, Homestore sought to recover an account receivable from Investor's Plus' parent, IPG, totaling between $5 and $6 million. In the first leg of the transaction, Homestore agreed to transfer the spun-off assets back to IPG and forgive the accounts receivable; in exchange IPG agreed to give Homestore a web site valued at $6 million. In the second leg of the transaction, IPG agreed to purchase advertising from AOL, and, in turn, AOL agreed to purchase advertising from Homestore; IPG did not have to pay the accounts receivable to Homestore. Under a revenue sharing agreement between AOL and Homestore in the third leg of the transaction, each company separately booked their purported revenue.

421. In entering into these deals, Investor Plus knew that in order to maintain its purported value, it would have to continue to increase its revenues and these transactions allowed Investor Plus and IPG to appear more successful than they actually were. By knowingly accepting the money as a *quid pro quo* and because the nature of the transaction which resulted neither company receiving cash but yet allowed both companies to tout to the market increased business, Investor Plus also knew that it was engaging in an improper transaction.

viii. **Privista, Inc.**

422. Beginning in 2000, Defendant Homestore and Privista entered into a fraudulent reciprocal transaction. According to Plaintiff's confidential sources, Homestore dealt with an employee of Privista who knew and agreed to the fraudulent nature of the transaction. In the first leg of the transaction, Homestore paid cash to Privista in exchange for advertising and other services. In the second leg or reciprocal component of the transaction, Privista recycled the cash paid by Homestore back to Homestore as payment for Homestore's purported advertising and other services. Privista knew that in order to obtain sufficient market value to go public, it would have to continue to increase its revenues and this transaction allowed Privista to appear more successful than it actually was. By knowingly accepting the money as a *quid pro quo* and because the nature of the transaction which resulted neither company receiving cash but yet allowed both companies to tout to the market increased business, Privista also knew that it was engaging in an improper transaction. PWC passed the deal despite reversing revenue recognition on other similar deals.

ix. **PromiseMark, Inc.**

423. Beginning in 2000, Defendant Homestore and PromiseMark entered into a fraudulent reciprocal transaction. According to Plaintiff's confidential sources, Homestore dealt with an employee of PromiseMark who knew and agreed to the fraudulent nature of the transaction. In the first leg of the transaction, Homestore paid cash to PromiseMark in exchange for advertising and other services. In the second leg or reciprocal component of the transaction, PromiseMark recycled the cash paid by Homestore back to Homestore as payment for Homestore's purported advertising and other services. PromiseMark knew that in order to obtain sufficient market value to go public, it would have to continue to increase its revenues and this transaction allowed PromiseMark to appear more successful than it actually was. By knowingly accepting the money as a *quid pro*

quo and through the nature of the transaction which resulted in no cash to either company yet allowed both companies to tout to the market increased business, PromiseMark also knew that it was engaging in an improper transaction.

x. Revbox, Inc.

424. Beginning in 2000, Defendant Homestore and Revbox entered into a fraudulent reciprocal transaction. According to Plaintiff's confidential sources, Homestore dealt with an employee of Revbox who knew and agreed to the fraudulent nature of the transaction. In the first leg of the transaction, Homestore agreed to provide website advertising to Revbox and also purchased its stock with cash. In the second leg or reciprocal component of this transaction, Revbox agreed to recycle the cash paid by Homestore back to Homestore as payment for Homestore's web site advertising and provided stock in its company to Homestore. Revbox knew that in order to obtain sufficient market value to go public, it would have to continue to increase its revenues and this transaction allowed Homestore to appear more successful than it actually was. By knowingly accepting the money as a *quid pro quo* and because the nature of the transaction which resulted neither company receiving cash but yet allowed both companies to tout to the market increased business, Revbox also knew that it was engaging in an improper transaction.

xi. SmartHome, Inc.

425. Beginning in 2000, Defendant Homestore and SmartHome entered into a fraudulent reciprocal transaction. According to Plaintiff's confidential sources, Homestore dealt with an employee of SmartHome who knew and agreed to the fraudulent nature of the transaction. In the first leg of the transaction, Homestore agreed to provide website advertising to SmartHome and also purchased its stock with cash. In the second leg or reciprocal component of this transaction, SmartHome agreed to recycle the cash paid by Homestore back to Homestore as payment for Homestore's web site advertising and provided stock in

its company to Homestore. SmartHome knew that in order to obtain sufficient market value to go public, it would have to continue to increase its revenues and this transaction allowed SmartHome to appear more successful than it actually was. By knowingly accepting the money as a *quid pro quo* and because the nature of the transaction which resulted neither company receiving cash but yet allowed both companies to tout to the market increased business, SmartHome also knew that it was engaging in an improper transaction.

xii. WizShop.com, Inc. (acquired by Semotus)

426. Beginning in the last quarter of 2000/first quarter 2001, Defendants Homestore, AOL and WizShop entered into a fraudulent triangular transaction. According to Plaintiff's confidential sources, Homestore dealt with an employee of WizShop who knew and agreed to the fraudulent nature of the transaction and received money off the top from the deal. In the first leg, Homestore paid cash to WizShop for sham services, technology, advertising or content. The deal was designed to look as if it was a stand alone deal. In the second leg of the transaction, AOL paid cash to Homestore for advertising placed by Homestore on AOL. The third leg was the source of the money and the *quid pro quo* for the deal. WizShop bought advertising with AOL and used the Homestore money which was being "roundtripped" back to them." WizShop knew that in order to obtain sufficient market value to go public, it would have to continue to increase its revenues and this transaction allowed WizShop to appear more successful than it actually was. By knowingly accepting the money as a *quid pro quo* and because the nature of the transaction which resulted neither company receiving cash but yet allowed both companies to tout to the market increased business, WizShop also knew that it was engaging in an improper transaction.

K. Scienter and the Conduct of the Individuals

427. The Individual Homestore Defendants, because of their positions as officers, directors, and employees of Homestore had the authority to facilitate, as

well as prevent the fraudulent events that occurred. The Individual Homestore Defendants had control over the misleading content of the quarterly and annual reports while at the same time having inside access to non-public, contradictory information, including Homestore's finances, products, markets, and present and future business opportunities. With full access to, and knowledge of, internal documents coupled with interactions with Homestore's management team, meetings and committees thereof, and employees, these Individual Homestore Defendants helped to create fraudulent filings and the false favorable reports surrounding them. Furthermore, they could have prevented the release, to the press, securities analysts and SEC, of these fraudulent filings and reports. The Individual Homestore Defendants deliberately disregarded the impact that their misleading statements and omissions would have on the Homestore stock and the integrity of the market. For all of the above reasons, the Individual Homestore Defendants have acted with scienter.

428. The Individual Homestore Defendants named herein participated in insider trading. The timing of the stock sales by the Individual Homestore Defendants reflects and highlights their improper intentions. There were common "large trading days" on April 30, May 1, May 2, July 30, July 31 and August 1, 2001, where most of the Defendants sold stock. Significantly, a majority Individual Homestore Defendants sold substantial numbers of their shares relative to their own personal trading histories.

429. The timing of these insider trades were designed to optimize the individual Homestore Defendants' profits. According to Plaintiff's confidential sources who personally benefitted from this scheme, company insiders had a quarterly "trading window" of approximately 30 days within which they could sell their shares. The trading window was established at the time of Homestore's initial public offering. Each trading window opened 3 days after the release of quarterly earnings reports, which usually occurred 3 to 4 weeks after the end of the

quarter for which the report was released; the window closed 30 days before the start of the next quarter. In the first and second quarters of 2001, Individual Homestore Defendants' insider trades were executed immediately after the window opened when Homestore's stock price was rising in response to the market's positive reaction to the company's glowing earnings reports. See, Exhibit F.

430. For example, Homestore released its earnings report for the First Quarter of 2001 on April 25, 2001. That release highlighted the company's record performance with the third consecutive month of cash profitability, with pro forma revenues for Q1 up 105 percent to $118.4 million from Q1 of 2000. Homestore's reported record profitability in what Wolff described as "a very difficult market", bolstered the price of its stock to benefit Individual Homestore Defendants' insider trades. Indeed, one round of Individual Homestore Defendants' large trading days took place within days of that April 25th release, in April and early May.

431. Similarly, Individual Homestore Defendants' insider trades in late-July and early-August, 2001 immediately followed the company's July 25, 2001 earnings report, touting Homestore's record revenues and eighth consecutive quarter of strong results. Again, Homestore's reported record profits increased the price of its stock in what Wolff reiterated was a "difficult market climate" which further benefitted Individual Homestore Defendants' insider trades.

432. The Individual Homestore Defendants insiders traded in unusually high volumes on common days. As depicted in the following chart, these "large trading days" coincided with Homestore's press releases announcing favorable financial results. Defendants' unusual trading volume combined with the conduct described herein establishes a strong inference of fraud throughout the Class Period.

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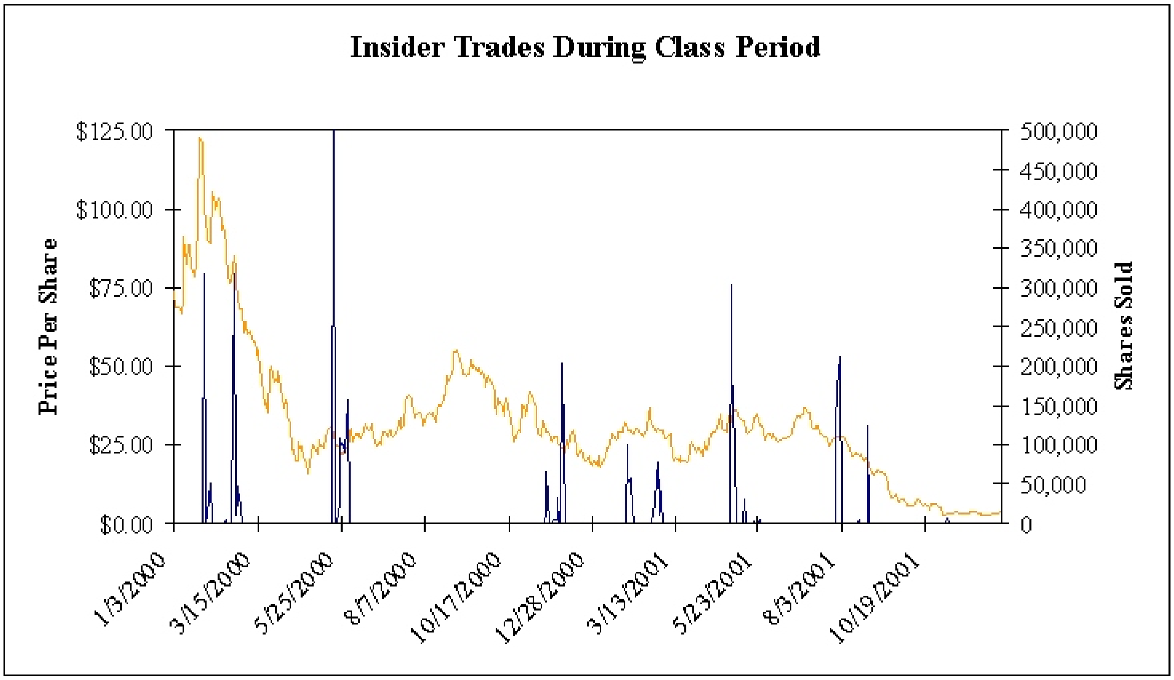

433. In addition to their improper stock sales, Individual Homestore Defendants obtained large numbers of stock options. An option is a right to buy the stock of a company at a pre-determined price, usually at or below the current market value when the option is given; when the value of the stock increases, the option becomes more valuable to the recipient, or the holder of the option. Proponents of stock options tout options as a means of aligning the interests of recipients with those of shareholders. However, rather than aligning the interest of recipients with shareholders, in reality, options can create a perverse incentive for recipients to inflate the value of the stock by any means in order to trade the options at the greatest possible profit. The facts of this case as alleged herein indicate that this conflict affected Defendants.

434. Indeed, to reconcile this conflict, one Fortune 500 company announced on July 14, 2002 that it would change its accounting methods to reflect that stock options are a form of employee compensation expense. That company stated that by booking options as an expense they will ensure that earnings more

clearly reflect the company's economic reality when compensation costs are recorded in financial statements.

435. By granting Individual Homestore Defendants and others options to purchase stock at a preset price, Homestore encouraged Defendants to take any action necessary to ensure that the price of Homestore common stock rose above that price. Namely, if Individual Homestore Defendants could exercise options at a price lower than the current trading price for Homestore stock, they could immediately turn around and sell the stock for a profit. Defendants have the discretion to exercise their options to purchase Homestore common stock at any time after the options have vested, but within ten years of the date the options are granted. At Homestore, this resulted in Defendants' financial motivation to knowingly recognize barter transactions as revenue and to falsely disseminate these misleading financial results to the investing public as part of their scheme to defraud the public.

436. The Individual Defendants participated actively during the course of and in furtherance of the scheme to defraud to recognize false revenues for Homestore, and conceal such information from the public. The acts of the Individual Defendants were intended to promote the objectives of the scheme to defraud. The Individual Defendants knowingly and intentionally particpated in Homestore's scheme to defraud.

1. <u>Stuart H. Wolff</u>

437. At all times alleged, Wolff was the Chief Executive Officer and Chairman of Homestore who knowingly and intentionally participated in Homestore's scheme to defraud. Plaintiff's confidential sources, characterize Wolff as a controlling person and said that Wolff had to "have his hands in everything." Wolff insisted on approving everything, and, thus, was in a position to know how revenue was being recognized. Wolff was also intimately involved in Homestore's statements to analysts, investors and the public. He was

repeatedly quoted in Homestore's press releases as herein alleged, and consistently made statements falsely hyping the value of Homestore's stock. Additionally, Wolff signed each of Homestore's misleading SEC filings during the Class Period.

438. According to Plaintiff's confidential sources, once the internal investigation into Homestore's improper transactions began, Wolff met with various high ranking executives and officers of Homestore to determine what each of them would tell the internal investigators about Homestore's improprieties. According to Plaintiff's confidential sources, Wolff reportedly went so far as to say "the Homestore team must stick together."

439. According to Plaintiff's confidential sources Wolff was fixated with setting Homestore's revenue growth targets unrealistically at or above those set by other Internet companies. During April 2001, Wolff was setting Homestore's revenue growth targets at or above those of eBay and Amazon.com. Wolff's growth targets set the stage for Homestore's fraudulent transactions.

440. According to Plaintiff's confidential sources, on or about April 11, 2001, Shew and Wolff had a lunch meeting. At this meeting Shew told Wolff that he was uncomfortable with the first quarter 2001 deal with AOL, and said that he did not feel right about facing PWC. Wolff replied by agree in, but reassuring Shew that it was a one time deal, and that the AOL acquisition or a turn in the economy would save Homestore.

441. On May 7, 2001, Homestore held a company retreat at the Cal Amigos Ranch. Before this meeting, Wolff, Tafeen, Shew, and Giesecke attended a, "pre-meeting," at which they discussed the fact that Homestore would not make its second quarter numbers, and that it had to do another AOL deal, similar to the first quarter AOL deal.

442. According to Plaintiff's confidential sources, DeSimone was instructed by Shew to create a schedule depicting the overall cost to Homestore of the SAG's low quality deals. These schedules demonstrated that Homestore's

expenses were three times greater than its revenues from these deals. According to Plaintiff's confidential sources, at a meeting on or about May 21, 2001,Wolff was shown and reviewed these charts.

443. According to Plaintiff's confidential sources, both Wolff and Tafeen were the most involved in the discussions with AOL regarding the potential acquisition of Homestore, which was known within Homestore as the "Final Four."

444. While these actions were contrary to his corporate responsibilities they were personally profitable. The massive number of options granted to Wolff created an incentive to inflate Homestore's stock price so that he could exercise his stock options and sell his stock at prices well above market value. According to Plaintiff's confidential sources, Wolff was obsessed with increasing the value of Homestore common stock in order to sell his shares at the highest possible profit. Moreover, Plaintiff's confidential sources recall that Wolff stated he wanted to "get the more bang out of his buck," for his stock. On June 29, 2000, Wolff was granted 400,000 options with an exercise price of $26.56 which would vest monthly over four years. At December 31, 2000, Wolff had 549,999 exercisable and 350,001 unexercisable options.

445. On January 12, 2001, Wolff was granted an additional 900,000 options with an exercise price of $24.00 which would vest as follows: 20% become exercisable one year after the date of grant, subsequently vesting on a monthly basis for the next 48 months. On December 31, 2001, Wolff had 743,749 exercisable and 1,064,586 unexercisable options. The massive grant of stock options created perverse conflicts of interest for Defendant Wolff relative to his fiduciary duties and obligations to the company and shareholders, including members of the Class.

446. The millions of options granted to Wolff at below market value created incentive for Wolff to inflate the common stock price of Homestore in an

effort to assure that he would be able to sell his shares at a price above the exercise price for sizeable personal profits. According to Plaintiff's confidential sources, Wolff was obsessed with inflating the value of Homestore's stock and this is precisely what he did. He participated in the wrongful conduct herein alleged, and had specific knowledge of the same as hereinabove alleged in paragraphs above.

447. During the Class Period, Defendant Wolff sold 693,600 shares of Homestore stock, as set forth below, while in possession of material, adverse, non-public information. Wolff's stock sales are reflected in the following chart.

Date	Insider	Shares Sold	Sale Price	Proceeds
11/17/2000	Wolff	13,000	$29.12	$378,560.00
11/24/2000	Wolff	1,000	$28.50	$28,500.00
11/27/2000	Wolff	1,000	$28.50	$28,500.00
11/28/2000	Wolff	5,900	$26.70	$157,530.00
11/30/2000	Wolff	450	$25.00	$11,250.00
12/1/2000	Wolff	38,650	$25.62	$990,213.00
1/30/2001	Wolff	23,750	$30.14	$715,825.00
1/31/2001	Wolff	11,875	$30.01	$356,368.75
2/1/2001	Wolff	11,875	$29.44	$349,600.00
2/22/2001	Wolff	12,000	$30.00	$360,000.00
2/23/2001	Wolff	14,000	$29.51	$413,140.00
2/26/2001	Wolff	18,500	$29.34	$542,790.00
2/27/2001	Wolff	6,100	$29.53	$180,133.00
2/28/2001	Wolff	15,000	$29.59	$443,850.00
4/30/2001	Wolff	44,000	$32.46	$1,428,240.00
5/1/2001	Wolff	106,000	$32.49	$3,443,940.00
5/2/2001	Wolff	20,000	$33.66	$673,200.00
7/31/2001	Wolff	47,000	$27.55	$1,294,850.00
7/31/2001	Wolff	9,000	$27.55	$247,950.00
8/1/2001	Wolff	57,000	$27.47	$1,565,790.00
		456,100		**$13,610,229.75**

2. Peter B. Tafeen

448. Tafeen, at all times alleged herein, was the Executive Vice President of Business Development and Sales who knowingly and intentionally caused barter transactions to be entered into, and for those transactions to be improperly recorded as revenue with the intent and for the purpose of inflating the price of Homestore's common stock.

449. According to Plaintiff's confidential sources, Tafeen was Homestore's deal maker, and the miraculous end of quarter deals which prevented Wall Street disappointment were called "Peter Deals" or "Peter Specials." Many of these deals as herein alleged were fraudulent and served to artificially inflate the revenues of Homestore.

450. Tafeen was known as the "rainmaker" because he miraculously brought in sales at the last minute of each quarter so that Homestore could report "better than last quarter results" or "make the bogie" as Tafeen liked to characterize efforts to exceed quarterly projections. Tafeen also enjoyed his self-anointed nickname of "piranha" because of the voracious manner in which he pursued Homestore's business plan including quarterly profits. See January 13, 2000, *Realty Times*, "Peter Tafeen: The Prince or Piranha of Homestore?" September 27, 2002, *The New York Times*, "From 'Piranha' At Homestore To Key Role In U.S. Inquiry."

451. According to Plaintiff's investigation, Tafeen knowingly and intentionally participated in the scheme to defraud and was one of the principal insiders at the company who directed the revenue recognition manipulation.

452. Plaintiff's confidential sources revealed that in March of 2001, Tafeen and Keller devised a scheme to make up Homestore's $15 million shortfall in revenue. Tafeen described the deal as "scary in how perfect it was." This deal was to be a one-time deal, until AOL acquired Homestore in the second quarter. Tafeen probably took more credit for the idea behind the deal than he deserved.

453. According to Plaintiff's confidential source, DeSimone was instructed to create a schedule showing how the deals entered into by the SAG were hurting Homestore, which were shown to Wolff, Giesecke, Shew and DeSimone. In response, Tafeen created his own schedule in an attempt to defend the Business Development team and specifically the SAG, and to portray himself as the "hero" of Homestore. At one point when DeSimone expressed concern about the low quality deals that Homestore was entering into, Tafeen responded by saying that Homestore had to "live to fight another day."

454. According to Plaintiff's confidential sources, both Tafeen and Wolff were the most involved in the discussions with AOL regarding the potential acquisition of Homestore, which was known within Homestore as the "Final Four." Tafeen told Shew of a conversation with Keller in which Tafeen said, "Why don't you guys just buy us?" At a meeting on or about March 23, 2001, Tafeen presented the proposed AOL acquisition to Wolff, Shew, and Giesecke

455. Tafeen was personally responsible for several of Homestore's restated transactions. For example, Tafeen used his connections with Keller at AOL to construct the fraudulent AOL transaction as hereinabove alleged. Moreover, Tafeen knowingly and intentionally entered into the second quarter of 2001 Cendant transaction which later had to be restated as hereinabove alleged. Tafeen intentionally signed the "give-back" contract with Cendant and attempted to hide the "give-back" contract until after his departure from Homestore. Tafeen was quoted as saying that Cendant would help Homestore make its third quarter 2001 numbers because "Cendant has $10-$20 million and they're on our team, but we'll have to make it up to them."

456. During the Class Period, Defendant Tafeen sold 439,195 shares of Homestore, as set forth below, while in possession of material, adverse, non-public information. Wolff made a point of instructing Tafeen on how to sell his

stock holdings in Homestore without alarming Wall Street. Tafeen's stock sales are reflected in the following chart.

Date	Insider	Shares Sold	Sale Price	Proceeds
5/31/2000	Tafeen	30,000	$23.49	$704,700.00
11/17/2000	Tafeen	13,000	$29.12	$378,560.00
11/24/2000	Tafeen	1,000	$28.50	$28,500.00
11/27/2000	Tafeen	1,000	$28.50	$28,500.00
11/28/2000	Tafeen	5,900	$26.70	$157,530.00
11/30/2000	Tafeen	450	$25.00	$11,250.00
12/1/2000	Tafeen	38,650	$25.62	$990,213.00
1/30/2001	Tafeen	23,750	$30.14	$715,825.00
1/31/2001	Tafeen	11,875	$30.01	$356,368.75
2/1/2001	Tafeen	11,875	$29.44	$349,600.00
2/22/2001	Tafeen	12,000	$30.00	$360,000.00
2/23/2001	Tafeen	14,000	$29.51	$413,140.00
2/26/2001	Tafeen	18,500	$29.34	$542,790.00
2/28/2001	Tafeen	15,000	$29.59	$443,850.00
4/30/2001	Tafeen	35,000	$32.46	$1,136,100.00
5/1/2001	Tafeen	85,000	$32.49	$2,761,650.00
5/2/2001	Tafeen	12,195	$33.60	$409,752.00
7/31/2001	Tafeen	55,000	$27.55	$1,515,250.00
8/1/2001	Tafeen	55,000	$27.47	$1,510,850.00
		439,195		**$12,814,428.75**

457. Tafeen also benefitted from a significant number of options. On June 29, 2000, Tafeen was granted 100,000 options with an exercise price of $26.56 which would vest monthly over four years. As of December 31, 2000,Tafeen had 114,224 exercisable and 100,000 unexercisable options. By granting hundreds of thousands of options to Tafeen, Homestore created his incentive to harvest enormous personal profit at the expense of Homestore investors and members of the Class.

3. David M. Rosenblatt

458. Rosenblatt was the General Counsel of Homestore who, like other Defendants, sold 255,100 shares of Homestore stock, as set forth below, while in possession of material, adverse, non-public information. Wolff made a point of instructing Rosenblatt on how to sell his stock holdings in Homestore without alarming Wall Street.

459. According to Plaintiff's confidential sources, Rosenblatt was aware of and participated in the scheme to defraud Homestore investors and members of the Class. Rosenblatt was known to regularly participate in closed-door meeting with Tafeen and Wolff.

460. According to Plaintiff's confidential sources, Rosenblatt was close to Tafeen and participated in the negotiations and documentation of Homestore's transactions, was fully knowledgeable about the transactions, had an opportunity to see all legs of the transactions and knew that they were "bogus." Rosenblatt insisted that an attorney be present during these negotiations even if it was not him personally.

461. According to Plaintiff's confidential sources, Rosenblatt was involved in closed-door meetings with Tafeen and Wolff, which Giesecke and Shew were not permitted to attend. Rosenblatt also attended meetings to discuss Homestore's shift in strategy from round trip transactions to acquisitions.

462. Plaintiff's confidential sources also stated that they had personal knowledge that Rosenblatt executed his "own deals" one of which was with Marriott. A July 19, 2000 Homestore Investor Relations Press Release entitled, "Homestore.com, Inc. Reports 252% Growth in Second Quarter," coincidentally also announced that it had "inked an alliance" with Marriott Vacation Club International, a wholly owned subsidiary of Marriott International, Inc., for advertising and custom web development services. The terms of the deal were not disclosed in the press release.

463. Another Rosenblatt deal also reported by Plaintiff's confidential sources involved Champion Enterprises, identified in the same press release as the largest homebuilder in the country, with whom Homestore expanded an earlier "alliance" to develop customized web technology solutions, including online marketing and training tools, for Champion's manufactured housing retailers. Again, the terms of the deal were not disclosed in the press release. Homestore also did deals with RealNames, where Rosenblatt's wife was a vice president.

464. According to plaintiff's confidential sources, Rosenblatt was directly involved in devising ways to cover up Homestore's financial problems resulting from these improper revenue buying deals. Plaintiff's confidential sources reported that Rosenblatt attended meetings during the third quarter of 2001 in which top executives including Merrill, Whelan, Ozonian and Sommer, and selected others discussed how Homestore could put a "spin" on the company's declining revenues. In these meetings, Merrill decided to blame the company's woes on the September 11 tragedy and a declining Internet advertising market.

465. Plaintiff's confidential sources also stated that Rosenblatt attended and/or participated in several in-house seminars or tutorials during which PWC and/or Shew sought to make company management aware of new revenue recognition policies, especially as they applied to barter transactions. According to Plaintiff's sources, PWC conducted these seminars partially as a result of this proposed Champion transaction in late 2000, in which PWC would not allow Homestore to recognize revenue of $2 to $3 million, and which led to increased scrutiny by PWC.

Date	Insider	Shares Sold	Sale Price	Proceeds
1/27/2000	Rosenblatt	30,000	$105.60	$3,168,000.00
11/17/2000	Rosenblatt	8,700	$29.12	$253,344.00
11/24/2000	Rosenblatt	700	$28.50	$19,950.00
11/27/2000	Rosenblatt	700	$28.50	$19,950.00

11/28/2000	Rosenblatt	3,300	$26.70	$88,110.00
11/30/2000	Rosenblatt	250	$25.00	$6,250.00
12/1/2000	Rosenblatt	19,450	$25.62	$498,309.00
1/30/2001	Rosenblatt	17,500	$30.14	$527,450.00
1/31/2001	Rosenblatt	8,750	$30.01	$262,587.50
2/1/2001	Rosenblatt	8,750	$29.44	$257,600.00
2/23/2001	Rosenblatt	11,500	$29.51	$339,365.00
2/26/2001	Rosenblatt	13,000	$29.34	$381,420.00
2/28/2001	Rosenblatt	10,500	$29.59	$310,695.00
4/30/2001	Rosenblatt	21,000	$32.46	$681,660.00
5/1/2001	Rosenblatt	14,000	$32.49	$454,860.00
5/2/2001	Rosenblatt	10,000	$35.03	$350,300.00
7/31/2001	Rosenblatt	39,000	$27.55	$1,074,450.00
8/1/2001	Rosenblatt	25,555	$27.47	$701,995.85
8/1/2001	Rosenblatt	12,445	$27.47	$341,864.15
		255,100		**$9,738,160.50**

466. In addition, as of December 31, 2000, Rosenblatt had 82,121 exercisable and 38,334 unexercisable options. By December 31, 2001, Rosenblatt had 66,566 exercisable and 37,084 unexercisable options. As with the other Defendants, the grant of options to Rosenblatt created incentive for Rosenblatt to participate in an effort to artificially inflate the price of Homestore common stock in an effort to harvest great personal profits.

4. <u>Catherine Kwong Giffen</u>

467. Giffen had access to adverse, non-public information about Homestore and used that inside information to personally benefit financially by selling her substantial holdings in Homestore stock to the detriment of shareholders and Class members. Giffen also directly participated in Homestore's scheme to deceive, manipulate, and/or defraud the market, by willfully making statements or omissions that were known or believed to be false or misleading at

the time and under the circumstances made, with the intent of artificially inflating the price of Homestore's common stock in order to induce the sale or purchase of Homestore's stock.

468. Giffen was the Senior Vice President of Human Resources at Homestore and, according to Plaintiff's confidential sources, was likely one of the first 30 employees of Homestore which may account for the reason that she held a substantial number of shares in the company.

469. Giffen had access to insider information directly from the top management executives in Homestore. Plaintiff's confidential sources disclosed, based on personal knowledge, that although Giffen's position was administrative, she attended meetings with the top management executives when material, non-public information was discussed. For example, Wolff made a point of instructing Giffen on how to sell her stock holdings in Homestore without alarming Wall Street.

470. Giffen also had access to insider information because of her intimate personal relationship with Giesecke, who at all times alleged was one of the top executives of Homestore, first as its Chief Financial Officer and then as the Chief Operating Officer. Giffen received inside information from Giesecke as well as the various meetings she attended where revenue recognition issues were discussed as alleged in the above paragraphs. Giffen and Giesecke were recently married.

471. As depicted in the chart below, Giffen benefitted personally from her access to adverse, non-public information. During the Class Period, Giffen sold 209,183 shares of Homestore stock for more than $8.1 million in insider trade proceeds.

Date	Insider	Shares Sold	Sale Price	Proceeds
1/27/2000	Giffen	17,920	$105.60	$1,892,352.00
1/27/2000	Giffen	4,998	$105.60	$527,788.80

1/27/2000	Giffen	2,082	$105.60	$219,859.20
11/24/2000	Giffen	400	$28.50	$11,400.00
11/27/2000	Giffen	400	$28.50	$11,400.00
11/28/2000	Giffen	2,500	$26.70	$66,750.00
11/30/2000	Giffen	200	$25.00	$5,000.00
12/1/2000	Giffen	16,100	$25.62	$412,482.00
1/30/2001	Giffen	7,500	$30.14	$226,050.00
1/31/2001	Giffen	3,750	$30.01	$112,537.50
2/1/2001	Giffen	3,750	$29.44	$110,400.00
2/23/2001	Giffen	4,000	$30.00	$120,000.00
2/26/2001	Giffen	10,000	$30.00	$300,000.00
2/27/2001	Giffen	1,000	$30.00	$30,000.00
4/30/2001	Giffen	50,000	$32.60	$1,630,000.00
5/10/2001	Giffen	30,000	$32.82	$984,600.00
7/30/2001	Giffen	30,445	$27.70	$843,326.50
7/31/2001	Giffen	5,138	$27.78	$142,733.64
8/1/2001	Giffen	19,000	$27.90	$530,100.00
		209,183		**$8,176,779.64**

5. <u>Allan P. Merrill</u>

472. Merrill was promoted to Executive Vice President of Corporate Development at Homebuilder.com, a Homestore subsidiary, in October of 2001; he joined Homebuider.com in April of 2000 as president. Merrill had personal knowledge that Homestore and its top executives were engaged in illegal revenue buying transactions. Merrill also directly participated in Homestore's scheme to deceive, manipulate, and/or defraud the market, by willfully making statements or omissions that were known or believed to be false or misleading at the time and under the circumstances made, with the intent of artificially inflating the price of Homestore's common stock in order to induce the sale or purchase of Homestore's stock.

473. Plaintiff's confidential sources disclosed that during the third quarter of 2001, Merrill was personally involved in meetings in which Homestore's new revenue buying strategy was discussed.

474. Merrill personally negotiated illegal revenue buying deals. According to Plaintiff's confidential sources, for example, Merrill was the architect of the $23 million deal involving Homestyles during the second quarter of 2001 as hereinabove alleged. The deal was presented to the Board of Directors as a $15 million deal but was later recorded in the minutes as a $23 million deal. Plaintiff's confidential sources believe that the board minutes were forged and that the additional $8 million was included to be used as part of a round trip transaction with AOL. Plaintiff's sources added that Merrill worked for months on this deal with Homestyles' parent company, Buildnet.com, and that it would be impossible for Merrill to feign ignorance of any improprieties involved in this deal. Merrill may have been assisted by Defendant Tafeen and Homestore employee Michael Maron. The Homestyles deal was negotiated through KPI, a subsidiary of Buildnet, to hide from PWC the fact that it involved related parties.

475. Merrill took credit for orchestrating the Homestyles revenue buying deal until the Audit Committee initiated an internal investigation. According to Plaintiff's confidential sources, after the deal was executed, there was a so-called "feel good" meeting between Homestore and Homestyles which Plaintiff's sources attended with Merrill and another Homestore employee, Clayton Chan. When the question was raised as to who would be in charge of the Homestyles account, Merrill insisted that he be in charge because, he asserted, it was *his* deal. However, after the Homestore Board of Directors initiated an internal investigation into the propriety of this transaction, Merrill did an about face and changed his story, telling one of Plaintiff's confidential sources, "All I can tell you is it looks like the deal as I know it did not happen, and you and I may be deposed."

476. Merrill also asserted himself into an executive deal-maker role at Homestore after the sudden departure of Tafeen. According to Plaintiff's confidential sources, after Tafeen moved to Florida, Merrill essentially took over Tafeen's position as deal-maker and, in fact, was vying for Shew's position as Chief Financial Officer of Homestore because he knew that Wolff was unhappy with Shew.

477. Merrill's personal attempts to legitimize the third quarter 2001 L90 revenue buying deal exemplify his efforts to become Homestore's deal-maker as hereinafter alleged. According to Plaintiff's confidential sources, Withey of PWC refused to approve Homestore's 10Q for the Third Quarter of 2001 unless a signed confirmation letter was obtained from L90 to substantiate the legitimacy of the transaction. Merrill then advised Shew that Mark Roah, founder and board member of L90, demanded payment of approximately $100,000 from Homestore in exchange for the confirmation letter. When Tafeen's assistance was requested to help obtain the confirmation from L90, Tafeen was reported by Plaintiff's confidential sources to have refused on the grounds that the L90 deal was the problem of Merrill or Vo. As a result, Merrill took charge and set up a conference call with Roah on or about November 13, 2001 which was also attended by Vo. During this call, Roah indicated that he no longer wanted payment, but wanted some kind of continuing business relationship between Homestore and himself personally. Roah refused to sign the confirmation letter because he would become personally liable; he was told that Homestore would be forced to restate its third quarter financials without the confirmation. After the call, Roah relented and signed a confirmation letter at 10:30 p.m. on November 13, 2001.

478. Merrill was also directly involved in devising ways to cover up Homestore's financial problems resulting from these improper revenue buying deals. Plaintiff's confidential sources reported that Merrill attended meetings during the third quarter of 2001 in which top executives including Rosenblatt,

Whelan, Ozonian and Sommer, and selected others discussed how Homestore could put a "spin" on the company's declining revenues. In these meetings, Merrill and the others decided to blame the company's woes on the September 11 tragedy and a declining Internet advertising market.

479. Merrill's asserted power play took a dramatic turn when Homestore's Board of Directors initiated an internal investigation into the propriety of the company's reciprocal transactions. Merrill told Plaintiff's confidential sources that he was concerned about how he should respond to Barbara Alexander of the Audit Committee when she asked him point blank whether Homestore was buying revenue. Merrill was told by Giesecke, "you're f***ed dude!"

6. <u>Sophia Losh</u>

480. Losh had personal knowledge of and involvement in Homestore's improper transactions. Losh was the Senior Vice President of Homestore's Strategic Alliances Group ("SAG"). Losh worked directly under Tafeen and was personally involved in his deals. Losh also directly participated in Homestore's scheme to deceive, manipulate, and/or defraud the market, by willfully making statements or omissions that were known or believed to be false or misleading at the time and under the circumstances made, with the intent of artificially inflating the price of Homestore's common stock in order to induce the sale or purchase of Homestore's stock.

481. According to Plaintiff's confidential sources, Losh had the last word on Homestore's financials before they were disclosed to the public. Losh's primary responsibility was to handle the accounting of advertising revenue. By the second and third quarters of 2001, Plaintiff's confidential sources indicated that Losh focused on large finance clients; Clayton Chan, who worked under Losh, then became Senior Vice President. According to Plaintiff's confidential sources, from the third quarter of 2001, Losh and Chan interacted with Merrill who stepped into Tafeen's role as Homestore's deal-maker.

482. Losh was personally responsible for key aspects of a number of the improper reciprocal deals. By way of example, according to Plaintiff's confidential sources, Losh was responsible for administering the triangular reciprocal deal with AOL in Q3 and Q4 of 1999 and independently negotiated with AOL (as did Tafeen and Kalina) to reconcile collection and revenue recognition issues with AOL so that another reciprocal deal pending in Q2 2001 could be executed as hereinabove alleged.

483. Losh also had intimate knowledge of the mechanics of these improper deals. By way of example, according to Plaintiff's confidential sources, Losh drafted a June 1, 2001 e-mail to Kalina in which she listed the AOL triangular deal partners and listed the revenue and expense sides of the transactions. She also had personal knowledge about the extortion threat that purportedly led to the GlobeXplorer payment and she was involved in collection issues involving GMAC as hereinabove alleged.

484. Losh was characterized by Plaintiff's confidential sources as "difficult" and "incompetent." She purportedly made untenable commitments and decisions about reciprocal deals and "almost blew several deals." She made a commitment to Budget, for example, that the company could not keep; she and Tafeen also promised employees in Business Development, including Mike Zwerner, that they would receive stock options, without approval of any executive or board member. Losh also gave herself a job title promotion without authorization from the company or management. According to Plaintiff's confidential sources, Losh has insider proceeds from her sale of Homestore stock in excess of $4 million.

7. <u>Jeff Kalina</u>

485. Kalina was, at all times alleged, a member of the Business Development team at Homestore. Kalina directly participated in Homestore's scheme to deceive, manipulate, and/or defraud the market, by willfully making

statements or omissions that were known to be false or misleading at the time and under the circumstances made, or were believed to be false or misleading at the time and under the circumstances made, with the intent of artificially inflating the price of Homestore's common stock in order to induce the sale or purchase of Homestore's stock.

486. Kalina had intimate knowledge of and participated in a number of illegal Homestore transactions. Kalina was a former employee of PWC and friends with several of the Individual Homestore Defendants and others who were also former PWC employees before they joined Homestore. According to Plaintiff's confidential sources, Kalina was in charge of the first quarter 2001 AOL deal, one of the "Peter Deals." Kalina was warned by a member of PWC's audit team, Jester, to be careful because PWC believed that Homestore was being overly aggressive in booking revenue. Kalina was also involved in a collection dispute involving AOL and Homestore and was copied on a July 6, 2001 e-mail regarding this dispute.

487. According to Plaintiff's confidential sources, Kalina was involved in a confidential meeting regarding the possible acquisition of Homestore by AOL in March of 2001. Tafeen instructed Kalina and DeSimone to figure out a way to make AOL give up the $50 million per year that it was entitled to receive from the first quarter deal that it would lose if it were to acquire Homestore. This led Kalina to devise a purchase accounting method, whereby this revenue could be preserved.

488. Kalina was also involved in devising Homestore's reciprocal transactions involving AOL. Kalina helped create a method of hiding the improper and triangular nature of the deals from PWC. One of Plaintiff's sources reported instructing Kalina to prepare a schedule of the AOL. Thus, Kalina has personal knowledge of these improper deals. Kalina was asked to edit the same schedule to depict more clearly the third leg of the triangular deals that Homestore

was hiding from PWC. Kalina created a format to ensure that PWC would not be able to connect any names and would not be able to figure out the third leg of the triangular deal. Kalina assured Plaintiff's sources that he and the Business Development and Finance Departments were taking additional steps to ensure that the third leg of the transactions would not be detected; this included making sure that companies involved with Homestore in the third leg of these deals did not have PWC as their auditor, reviewing the web sites of these third parties and checking the identities of these entities under different names. Plaintiff's sources believe that Kalina was the link between the Business Development and Finance Departments.

489. According to Plaintiff's sources, Kalina was involved in documenting the AOL deal for purposes of hiding the true nature of the transaction from PWC. After Keller had been terminated from AOL, Kalina participated in the conference call with AOL regarding the second quarter 2001 deal. AOL wanted documentation that would keep it from being considered a co-conspirator and wanted to list all third legs of these deals as an exhibit to their documentation. According to Plaintiff's sources, a solution was devised by Tafeen, Shew, DeSimone and Kalina, in which AOL would be asked to create a broad list and include the names of "dummy corporations" with which AOL and Homestore had no intention of dealing.

490. Kalina was also involved in making the Homestore deal with AOL work. According to Plaintiff's sources, in mid to late June 2001, Kalina was involved in a series of interactions and meetings between Tafeen, DeSimone and Shew regarding the AOL deal and AOL's ability to recognize revenue from the third party triangular deals. Kalina was also involved in phone conference calls with AOL's Ripp and Rindner to resolve AOL's concerns about getting paid. Kalina kept a payment schedule which identified the third parties in the AOL transactions and tracked which third parties had received payment from

Homestore. There were three categories of third party information on Kalina's list: (1) thinly capitalized, (2) cash constrained and (3) those who had previously done business with AOL. The list was maintained quarterly. One of Plaintiff's sources personally recalled many telephone calls and meetings involving Kalina during which Tafeen wanted to make sure that AOL was comfortable with the revenue.

491. Plaintiff's confidential sources also said that Kalina was personally involved in other improper Homestore transactions. By way of example, Plaintiff's sources first learned about the L90 deal from Kalina, Tafeen and DeSimone. It was Kalina and/or DeSimone who described the structure of this potential deal with L90. Kalina was also involved in the Cendant-iPIX deal, involving $15 million in virtual tours. Plaintiff's confidential sources believe that Kalina and DeSimone may have prepared the calculations which showed that the $15 million worth of tours was approximately three years of tours, where it was, in fact, far greater than three years worth. On or about September 28, 2001, Kalina informed Plaintiff's confidential sources that he had just spoken with Craig Hamway from Cendant who was insisting that the third quarter Cendant deal be fully documented and that Cendant be paid the $15 million it was owed before the first quarter of 2002. Kalina was instructed to advise Hamway that the agreement could not be signed until 2002, because the transactions could not happen too close together.

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8. <u>David Colburn</u>

492. Colburn was, at all times alleged, an Executive Vice President and head of the Business Affairs unit at AOL. Colburn directly participated in Homestore's scheme to deceive, manipulate, and/or defraud the market, by willfully making statements or omissions that were known or belived to be false or misleading at the time and under the circumstances made, with the intent of

artificially inflating the price of Homestore's common stock in order to induce the sale or purchase of Homestore's stock. Colburn was the direct superior of Eric Keller, who negotiated the transactions with Homestore on behalf of AOL. Colburn was dismissed from AOL in August of 2002, when the SEC initiated its investigation into the $49 million restatement involving certain barter transactions with Homestore.

493. Colburn had personal knowledge of and/or was directly involved on behalf of AOL in the deals with Homestore as hereinabove alleged. By way of example, according to Plaintiff's confidential sources, Colburn's knowledge and involvement is evidenced by a string of e-mails between himself and Homestore's Wolff related to the second quarter of 2001 AOL deal.

494. According to Plaintiff's confidential sources, Colburn was one of Homestore's contacts at AOL and was involved in structuring improper transactions in the first and second quarters of 2001. Colburn participated in several telephone conference calls with Homestore where the participants discussed the terms and execution of these improper transactions.

495. The media has also documented Colburn's personal involvement in the illegal AOL transactions. For example, the August 14, 2002, *Reuters* Internet Report entitled, "AOL May Have Overstated Revenue" stated that Colburn "was one of the key architects for the Internet giant's ad and commerce pacts." It was then that AOL announced that it would restate its revenues by $49 million over six quarters and confirmed that Colburn had left the company. An August 16, 2002, *CNNMoney* article, "AOL Probe Narrows" reported that Colburn "left the company under pressure last week after one of his former employees in the business-affairs division tipped off internal lawyers about a questionable transaction." The article continued to explain that this questionable transaction tipped off AOL's attorneys to three more "separate troubling transactions."

496. Indeed, Colburn's direct responsibility and role in negotiating these deals was confirmed in a September 1, 2002 *New York Times* article, "Ouster at AOL, but Where Does Trail End?", which characterized Colburn as "the point man in charge of negotiating advertising sales agreements for AOL, played a crucial role in most of AOL's reciprocal deals. . . ." It further noted that Colburn is "known for his meticulousness, his aggression and his eccentricity." <u>See</u> also, September 4, 2001 *news.com* , "AOL Overhaul on the Horizon" (announcing AOL's firing of Colburn, "AOL's head of business affairs, who is being investigated by the SEC."); September 27, 2001 *New York Times,* "From 'Piranha' at Homestore to Key Role in U.S. Inquiry."

9. <u>Eric Keller</u>

497. Keller, at all times alleged, was the Senior Vice President of AOL. Keller worked directly under David Colburn. Keller directly participated in Homestore's scheme to deceive, manipulate, and/or defraud the market, by willfully making statements or omissions that were known or believed to be false or misleading at the time and under the circumstances made, with the intent of artificially inflating the price of Homestore's common stock in order to induce the sale or purchase of Homestore's stock.

498. According to Plaintiff's confidential sources, Keller was close to Tafeen who may have also known AOL's Colburn and Ted Leonsis o AOL. Like Homestore, AOL struggled to meet its revenue projections, or to "hit its numbers," and a reciprocal transaction between Homestore and AOL would help generate revenues for both companies and make Keller and Colburn look like heroes in the process. Plaintiff's confidential sources believe that Tafeen and Keller likely devised the original transaction together.

499. Plaintiff's confidential sources reported that Keller may have brought in many of the third party companies with whom Homestore did deals. This source also said that Keller and Tafeen communicated primarily via telephone, but

he was aware that Tafeen would travel to the east coast a few times per year and visit with Keller. One of Plaintiff's confidential sources recalled a phone conference call in March of 2000 with Keller, which took place in Shew's office at Homestore's old office building and was attended by Tafeen, Giesecke, Angeles, Kim and possibly DeSimone. The topic of the call involved the provisions of a letter of credit related to the five-year AOL deal. Keller insisted that this letter was needed in order for AOL to recognize the stock as revenue. Keller's incentive to do the deals was not for the greater good of AOL, but for how it would make his division look.

500. Plaintiff's confidential sources revealed that in March of 2001, Tafeen and Keller devised a scheme to make up Homestore's $15 million shortfall in revenue. Tafeen described the deal as "scary in how perfect it was." This deal was to be a one-time deal, until AOL acquired Homestore in the second quarter.

501. Keller and Tafeen could not stop at one deal. By the Second Quarter of 2001, Keller and Tafeen created another deal worth $31.5 million. Plaintiff's confidential sources found out from Tafeen that Keller was fired by AOL for his involvement in PurchasePro, and the new management (Ripp and Rindner) at AOL was not willing to participate in the triangular transactions. This source found out from Tafeen that as a part of this deal, AOL was entitled to $8 million out of the $31.5 million from this transaction. At one point when this deal was falling apart, the Homestore AOL executives had a conference call to resolve the issues which were keeping the deal from being finalized. According to Plaintiff's confidential source who was present, Wolff argued to the AOL executives that Keller had already entered into the deal as an authorized agent of AOL, and had already agreed to the terms. At one point, Tafeen suggested that they all call Keller to get it straightened out. AOL was not receptive to this idea. Plaintiff's sources believe that AOL knew the substance of the deal, but wanted to distance itself from Keller.

502. Keller's involvement in creating the improper round-trip deals on behalf of AOL with Tafeen for Homestore has been confirmed by the media. By way of example, an August 2, 2002 *Washington Post* article entitled, "SEC Expands Probe of AOL," reported that AOL was under investigation by the SEC for its triangular deal with PurchasePro and Homestore. According to the article, the "PurchasePro deal was one of several unconventional transactions carried out by AOL at a critical time before and after its takeover of Time Warner Inc. in January 2001." The article also pointed out that Keller "was placed on administrative leave, pending an internal investigation of the company's relationship with PurchasePro." Keller was out on administrative leave and then dismissed by AOL.

503. The media also highlighted Tafeen's relationship with Keller. A September 27, 2002 *New York Times* article, "From 'Piranha' at Homestore to Key Role in U.S. Inquiry" reported that Tafeen (who characterized himself as a "piranha") was the Homestore deal maker who "worked closely with Eric Keller, an executive in AOL's business affairs department." According the article, the internal investigation revealed that Keller had tried to "backdate" a transaction with PurchasePro. An October 14, 2002 *New York Times* article entitled, "The Outer Limits of Optimism" reported that in June 2001, the company first noticed its accounting problems: "On June 19, AOL suspended one of its top deal makers, Eric Keller for negotiation of potentially improper round-tripping arrangements with tow of AOL's business partners, PurchasePro.com and Homestore.com."

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10. <u>Richard A. Smith</u>

504. Smith was, at all times alleged, President and Chief Executive Officer of Cendant and a member of the Board of Dsirectors of Homestore. Smith directly participated in Homestore's scheme to deceive, manipulate, and/or defraud the

market, by willfully making statements or omissions that were known or believed to be false or misleading at the time and under the circumstances made, with the intent of artificially inflating the price of Homestore's common stock in order to induce the sale or purchase of Homestore's stock.

505. According to Plaintiff's confidential sources Smith was a close friend of Wolff's and was a primary contact at Cendant in the structuring of the barter deals between Homestore and Cendant.

506. Smith was personally involved in arranging the improper deals on behalf of Cendant with Homestore. According to Plaintiff's confidential sources, in the Second Quarter of 2001, Homestore knew that it would come up short on its revenues. Smith agreed to do a deal with Homestore so that Homestore could recognize revenue in the Second Quarter of 2001, on condition that Homestore repay the favor in the First Quarter of 2002. The deal was structured by Tafeen who was told not to make any contracts in writing and to keep the deal oral. Tafeen, in fact, entered into written contracts with Cendant. PWC's Withey advised Wolff that the deal would have to be unwound. Plaintiff's confidential sources called Smith and told him that Tafeen did not have authority to enter into the contracts with Cendant and that Homestore will not honor those agreements. Cendant agreed to tear up the contracts and the transactions were nullified and therefore, Homestore could not report any revenue from this particular transaction. As a Board Member and part of Cendant's management, Smith knew both sides of the Cendant deals, and had a conflict of interest.

507. By the end of the Third Quarter of 2001, Plaintiff's confidential sources reported that there were concerns by Homestore's executives on how they could put a "spin" on the company's declining revenues. Smith attended the meeting with Rosenblatt, Whelan, Ozonian, Sommer and Denhart. Defendants decided to blame the company's woes on the September 11 tragedy and a

declining Internet advertising market. On March 5, 2002 Homestore issued a press release announcing the resignation of Smith from the Homestore board.

11. <u>Joseph J. Shew</u>

508. Shew was the Chief Financial Officer for Homestore. In his role as CFO, Shew had full access to and knowledge of the financial books and records of the company, attended and participated in audit committee meetings, was completely familiar with and responsible for establishing the accounting policies for Homestore, including but not limited to the revenue recognition rules. In this position of control and authority, Shew was able to and did control the contents of the company's reported financial statements, its SEC filings, press releases and information provided to securities analysts. Shew, in particular, was quite familiar with the accounting, auditing and reporting aspects of Homestore's revenue recognition policies as he was an auditor with Price Waterhouse LLP for six years and was the Director of Corporate Controllership for Walt Disney Company.

509. Shew, as CFO, was also responsible for establishing adequate internal accounting controls at Homestore, and assuring that the internal accounting controls were not materially weak, especially as they related to high risk audit areas such as revenue recognition. In his position as CFO, Defendant Shew was given copies of Homestore's SEC filings and press releases as well as the quarterly and yearly financial statements. He had the ability and opportunity to prevent the materially misleading statements hereinabove alleged, and could have caused the statements to be corrected even after issuance. Shew had access to adverse non-public information about the financial manipulation at Homestore based on his position, attendance at meetings of management, the Board and the committees of the Board, and by virtue of the reports on the financial condition, business and operation of the Company given to him on a regular basis. In fact, Shew was directly involved in and had personal knowledge of the fraudulent revenue recognition transactions as alleged herein.

510. On September 20, 2002, Shew pleaded guilty to violation of federal securities laws in relation to his participation in Homestore' illegal transactions.

511. During the Class Period, Shew sold 108,704 shares of Homestore stock, as set forth below, while in possession of material, adverse, non-public information which included the matters hereinafter alleged; and specifically the fact that the inclusion of improper barter transactions in the revenue figures led to inflation of those revenues, the probability of restatement, and the rendering of the revenues of Homestore an illusion. Wolff made a point of instructing Shew on how to sell his stock holdings in Homestore without alarming Wall Street.

Date	Insider	Shares Sold	Sale Price	Proceeds
1/27/2000	Shew	10,840	$105.60	$1,144,704.00
1/27/2000	Shew	4,160	$105.60	$439,296.00
1/27/2000	Shew	3,750	$105.60	$396,000.00
11/17/2000	Shew	5,400	$29.12	$157,248.00
11/24/2000	Shew	400	$28.50	$11,400.00
11/27/2000	Shew	400	$28.50	$11,400.00
11/28/2000	Shew	2,500	$26.70	$66,750.00
11/30/2000	Shew	200	$25.00	$5,000.00
12/1/2000	Shew	16,100	$25.62	$412,482.00
2/2/2001	Shew	15,000	$29.67	$445,050.00
2/28/2001	Shew	10,000	$30.00	$300,000.00
4/30/2001	Shew	15,000	$32.46	$486,900.00
4/30/2001	Shew	5,000	$32.60	$163,000.00
8/1/2001	Shew	10,593	$27.68	$293,214.24
8/1/2001	Shew	5,257	$27.68	$145,513.76
8/1/2001	Shew	4,104	$27.50	$112,860.00
		108,704		**$4,590,818.00**

12. <u>John M. Giesecke, Jr.</u>

512. Giesecke served as Executive Vice President and CFO until he was promoted to Executive Vice President and Chief Operating Officer. Giesecke

knew of, and participated in, the closing of deals and the manipulation of revenue numbers in an effort to meet Wall Street's expectations.

513. Giesecke, in particular, was quite familiar with the accounting, auditing and reporting aspects of Homestore's revenue recognition policies as he was an auditor with Price Waterhouse LLP for eight years and was Vice President of Corporate Controllership for Walt Disney Company.

514. In a May 28, 2001 article in the Industry Standard entitled, "Homestore Inspection: Analyze its stock deals and Homestore.com's dramatic success doesn't look so good anymore," Giesecke said of the questionable Homestore reporting that, "most technology companies report pro-forma results. These were not just stock-for-revenues deals. We are creating partnerships." Despite Giesecke's concession that many of Homestore's deals were not "stock-for-revenue," that is nevertheless how these deals were reported in the SEC filing that Giesecke signed as well as in other filings during the Class Period. In fact, the so-called revenue was nothing more than barter transactions with third parties.

515. According to Plaintiff's confidential sources, on or about November 13, 2001, Giesecke was involved in the process of obtaining a confirmation letter for PWC regarding Homestore's third quarter 2001 transaction with L90.

516. According to Plaintiff's confidential sources, Giesecke saw a schedule prepared by DeSimone at Shew's direction which demonstrated how the SAG deals were hurting Homestore.

517. On September 25, 2002, Giesecke pleaded guilty to violation of federal securities laws in relation to his participation in Homestore' illegal transactions.

518. During the Class Period, Giesecke sold 200,000 shares of Homestore stock, as set forth below, while in possession of material, adverse, non-public information. Wolff made a point of instructing Giesecke on how to sell his stock

holdings in Homestore without alarming Wall Street. Giesecke's stock sales are reflected in the following chart.

Date	Insider	Shares Sold	Sale Price	Proceeds
1/27/2000	Giesecke	4,998	$105.60	$527,788.80
1/27/2000	Giesecke	18,752	$105.60	$1,980,211.20
5/31/2000	Giesecke	5,000	$23.75	$118,750.00
5/31/2000	Giesecke	5,000	$23.81	$119,050.00
5/31/2000	Giesecke	10,000	$23.25	$232,500.00
11/17/2000	Giesecke	8,700	$29.12	$253,344.00
11/24/2000	Giesecke	700	$28.50	$19,950.00
11/27/2000	Giesecke	700	$28.50	$19,950.00
11/28/2000	Giesecke	4,000	$26.70	$106,800.00
11/30/2000	Giesecke	300	$25.00	$7,500.00
12/1/2000	Giesecke	25,600	$25.62	$655,872.00
1/30/2001	Giesecke	10,000	$30.14	$301,400.00
1/31/2001	Giesecke	5,000	$30.01	$150,050.00
2/1/2001	Giesecke	5,000	$29.44	$147,200.00
2/23/2001	Giesecke	4,000	$30.00	$120,000.00
2/26/2001	Giesecke	13,500	$30.00	$405,000.00
2/27/2001	Giesecke	2,500	$30.00	$75,000.00
4/30/2001	Giesecke	60,000	$32.60	$1,956,000.00
7/30/2001	Giesecke	30,000	$27.78	$833,400.00
7/31/2001	Giesecke	7,000	$27.78	$194,460.00
8/1/2001	Giesecke	23,000	$27.90	$641,700.00
		243,750		**$8,865,926.00**

519. On June 29, 2000, Giesecke was granted 200,000 options with an exercise price of $26.56 which would vest monthly over four years. At December 31, 2000, Giesecke had 217,906 exercisable and 266,684 unexercisable options. By granting hundreds of thousands of options to Giesecke, Homestore created his

incentive to harvest enormous personal profit at the expense of Homestore investors.

13. John D. DeSimone

520. John DeSimone served as Director of Operations, Planning and Transactions in the Finance Department from 1999 through June 2001. From June 2001 through October 2001, he served as Vice President of Transactions and was fully familiar with the daily transactions of Homestore. DeSimone knew of , and participated in, the closing of deals and the manipulation of revenue numbers in an effort to meet Wall Street's expectations.

521. According to Plaintiff's confidential sources, DeSimone was involved in the creation and maintenance of various schedules and reconciliations. DeSimone was asked by Shew in May of 2001 to generate a schedule depicting how the SAG's deals were hurting Homestore. Part of Desimone's duties was to determine whether PWC was the auditor for potential third parties in order to ensure that PWC would not discover the true round trip nature of the Homestore deals.

522. According to Plaintiff's confidential sources, DeSimone attended a July 6, 2001 conference call with Wolff, Shew, and Giesecke, and Rindner of AOL regarding the proposed third quarter deal with AOL fro $31 million. On this call, participants also discussed collection issues in connection with the AOL deal in the second quarter of 2001. In preparation for this discussion, DeSimone was asked to generate a reconciliation of the deals and amounts due to Homestore from AOL.

523. On September 25, 2002, DeSimone pleaded guilty to violation of federal securities laws in relation to his participation in Homestore' illegal transactions.

524. During the relevant Class Period, DeSimone sold 9,375 shares of Homestore stock, as set forth below, while in possession of material, adverse, non-

public information. DeSimone's stock sales are reflected in the following chart. Note that the sale price for the trade is the price at closing used as an estimate to calculate DeSimone's approximate proceeds.

Date	Insider	Shares Sold	Sale Price	Proceeds
4/30/2001	DeSimone	3,125	$31.95	$99,843.75
5/17/2001	DeSimone	1,562	$33.35	$52,092.70
8/17/2001	DeSimone	1,390	$21.66	$30,107.40
8/17/2001	DeSimone	1,598	$21.66	$34,612.68
8/17/2001	DeSimone	1,600	$21.66	$34,656.00
8/17/2001	DeSimone	100	$21.66	$2,166.00
		9,375		**$253,478.53**

L. Scienter and the Conduct of PricewaterhouseCoopers LLP

1. Overview Of PWC's Engagements With Homestore

525. PWC was retained by and has served as Homestore's independent auditor since 1999. PWC performed annual audits on Homestore's financial statements during the Class Period, including the financial statements for fiscal year ending 2000, as well as quarterly review work in 2000 and 2001.

526. PWC also performed services for Homestore's Initial Public Offering ("IPO") on August 5, 1999. In fact, according to public filings related to the IPO, PWC was involved in the due diligence for the IPO and was disclosed as an expert in the proxy materials and prospectus.

527. During the relevant period, PWC's auditing team at Homestore included Richard Withey, Mary Rose, Christian Jester, and Rob Page, among others. Withey is one of the leader's of PWC's "Software & Internet Sector" (part of PWC's Technology Department), and acted as PWC's partner in charge of the audit. Rose and Jester acted as the managers of the audit. Page served as an audit team member.

2. PWC's Responsibilities as Homestore's Independent Auditor

528. The responsibilities and functions of an independent auditor include the following:

> The objective of the ordinary audit of financial statements by the independent auditor is the expression of an opinion on the fairness with which they present, in all material respects, financial position, results of operations and cash flows, in conformity with generally accepted accounting principles. (AU 110.01)
>
> The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. (AU 110.02)
>
> The professional qualifications required of the independent auditor are those of a person with the education and experience to practice as such. (AU 110.04)

529. The independent auditor must also comply with professional training and proficiency rules, including the following:

> In the performance of the audit which leads to an opinion, the independent auditor holds itself out as one who is proficient in accounting and auditing. (AU 210.03)
>
> The independent auditor's formal education and professional experience compliment one another; each auditor exercising authority upon an engagement should weigh these attributes in determining the extent of his or her supervision of the subordinates and review of their work. It should be recognized that the training of a professional person includes a continual awareness of developments taking place in business and in his or her profession. (AU 210.04)
>
> In the course of his or her day-to-day practice, the independent auditor encounters a wide range of judgment on the part of management, varying from true objective judgment to the occasional extreme and deliberate misstatement. He or she is retained to audit and report upon financial statements of a business because, through training and experience, he or she has become skilled in accounting and auditing and has acquired the ability to consider objectively and to exercise independent judgment with respect to the information recorded in books of account or otherwise disclosed by his or her audit. (AU 210.05)

530. The independent auditor must comply with the rules of independence, including the following:

> "the auditor must be independent.....he must be without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be. However, independence does not imply the attitude of a prosecutor but rather a judicial impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to creditors and those who may otherwise rely (in part, at least) upon the independent auditor's report, as in the case of prospective owners or creditors." (AU 220.02)

531. PWC, in contracting to perform its audit of Homestore's financial statements, assumed all of the responsibilities and obligations set forth in the preceding paragraphs.

532. However, as discussed below, PWC violated its professional responsibilities, and knowingly or recklessly participated with Homestore in improper revenue recognition practices, policies, and procedures in order to artificially boost Homestore's reported revenue and profits. Although PWC was aware that the revenue recognition practices of Homestore were in violation of GAAP, PWC provided a "clean" audit opinion related to the company's financial statements in violation of GAAS in order to continue earning lucrative fees for the auditing and other services that it provided for Homestore.

533. As a result of PWC's violation of its obligations, and its knowing participation in the scheme to defraud, Homestore's shareholders, the public, and the SEC were provided materially false information concerning Homestore's revenues and earnings. At all times alleged herein, PWC participated in a scheme to defraud members of the Class in violation of Section 10(b) of the Exchange Act, 15 U.S.C. §78j(b), and Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated thereunder.

3. Evolution of Relevant Accounting Standards

534. Historically, the stock market valued companies based upon their net income (profitability). Beginning in the 1990s, there was an explosion of start-up

Internet companies which reported net losses and negative cash flows. The traditional valuation methods did not apply to the value of these companies, so the market began to value companies based upon revenues as an indicator of future earnings. As a result, there was increasing pressure on companies to report increasing revenues each reporting period to maintain or increase market valuation. Companies with earnings that did not meet the market's expectations saw their share prices plummet.

535. Similarly, the market's valuation of companies based on revenues made appropriate recognition of such revenues it an increasingly critical accounting issue. According to a study conducted by the Committee of Sponsoring Organizations of the Treadway Commission, more than half of the financial reporting frauds among U.S. public companies from 1987 to 1997 involved overstated revenues.

536. In the late 1990s, to address revenue recognition issues, the SEC issued new directives to ensure that companies had proper and consistent revenue reporting in their financial statements.

i. General Revenue Recognition: SEC SAB 101

537. In December of 1999, the SEC issued Staff Accounting Bulletin 101, 17 C.F.R. § 211 ("SAB 101"), to direct public companies and auditors on proper recognition, presentation, and disclosure of revenues in financial statements. Pursuant to SAB 101, revenues may not be recognized until they are "realized or realizable and earned." In order for revenues to be considered "realized or realizable and earned," they must meet all of the following criteria: i) pervasive evidence of an arrangement exists, ii) delivery has occurred or services have been rendered, iii) the seller's price to the buyer is fixed or determinable, and iv) collectability is reasonably assured.

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ii. Software Revenue Recognition: SOP 97-2

538. In October 1997, the AICPA issued Statement of Position 97-2 ("SOP 97-2"), entitled "Software Revenue Recognition." SOP 97-2 specifically pertains to revenue recognition in sales of software including revenue from software licenses. In December 1998, the AICPA issued SOP No. 98-9, "Modification of SOP No. 97-2, Software Revenue Recognition, with Respect to Certain Transactions." SOP No. 98-9 clarifies certain provisions of SOP No. 97-2, and effectively defers the required adoption of those provisions until the fiscal year beginning January 1, 2000.

539. SOP 97-2 provides that revenue should not be recognized on sales of software licenses until the product is delivered to the customer, i.e., end user. SOP 97-2 also provides that any right of return by distributors or other intermediaries requires that booking of revenue be deferred. According to SOP 97-2, the fact that the product is a license does not change the proper accounting procedures and practices should mirror those involved in the sales of products.

540. Under SOP 97-2, revenue for product licenses is recognized when a signed agreement or other persuasive evidence of an arrangement exists, the software or system has been shipped (or software has been electronically delivered), the license fee is fixed and determinable, and collection of the resulting receivable is probable. Under SOP 97-2, revenue generated from products sold through traditional channels where the right of return exists is reduced by reserves for estimated sales returns.

iii. Related Party Disclosures: FAS 57

541. Because guidance for related party disclosures was not included in the authoritative literature on GAAP, the Accounting Standards Division of the AICPA asked the FASB to provide guidance in a new statement of standards. In March 1982, the FASB issued FAS 57, governing "Related Party Disclosures," which was made effective for financial statements for fiscal years ending June 15,

1982 and thereafter. FAS 57 provides guidance in addition to AICPA SAS 6, Related Party Transactions, and SEC Regulation S-X, which applies to related party transactions for companies subject to SEC filing requirements.

542. FAS 57 requires that a company's financial statements include disclosures of material related party transactions, including the nature of the relationship involved, the dollar amounts involved, and a description of the transactions for each of the periods for which income statements are presented, including all information deemed necessary to an understanding of the effects of the transactions on the financial statements.

543. According to FAS 57, transactions involving related parties cannot be presumed to be carried out on at an arm's length basis, as the requisite conditions of competitive, free-market dealings may not exist. Representations about transactions with related parties, if made, shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's length transactions unless such representations can be substantiated.

544. Finally, under FAS 57, if the reporting enterprise and one or more other enterprises are under common ownership or management control and the existence of that control could result in operating results or financial position of the reporting enterprise significantly different from those that would have been obtained if the enterprises were autonomous, the nature of the control relationship must be disclosed, even if there are no transactions between the enterprises.

iv. <u>Bartering/Round Tripping: EITF No. 99-17</u>

545. Accounting for advertising barter transactions is dictated by Emerging Issues Task Force (EITF) Issue No. 99-17, "Accounting for Advertising Barter Transactions." EITF 99-17 became effective for transactions entered into after January 20, 2000.

546. The perceived necessity for EITF 99-17 is stated in the text of the rule:

> It has become increasingly popular for Internet companies to enter into transactions in which they exchange rights to place advertisements on each others' web sites. In some of these transactions, no cash is exchanged between the parties. In other transactions, similar amounts of cash is exchanged between the two parties.

547. Accordingly, the Task Force determined that revenue from barter transactions should be recognized at fair value only if the fair value of the advertising surrendered in the transaction is determinable based on the entity's own historical practice of receiving cash or cash equivalents for similar advertising from buyers unrelated to the counterparty in the barter transaction.

548. On December 7, 1999, just prior to the effective date of EITF 99-17, Richard H. Walker, the Director of the Division of Enforcement for the SEC, in a speech entitled "Behind the Numbers of the SEC's Recent Financial Fraud Cases" given to the AICPA, warned the accounting industry about barter transactions:

> In addition to these time-honored methods of inflating results, companies are also using novel and creative methods to cook the books. For example, we are beginning to see an increase in the use of "barter" transactions, especially among high-technology companies, where the assets received in exchange for goods and services provided are greatly overvalued. We brought 4 "barter" cases last year.

549. On December 8, 1999, Jane B. Adams, Deputy Chief Accountant of the SEC, again told AICPA members that proper accounting for barter transactions has become an increasingly critical area:

> <u>Gross vs. Net Income Statement Presentation and the Accounting for Barter Advertising Transactions</u>: With the emergence of Internet companies as a significant part of the economy and for which investment decisions have been based on revenues rather than earnings, income statement classification and presentation has become a critical area. The staff is seeing a number of accounting issues for which the underlying objective seems to be the grossing up of the income statement. . . . Barter transactions also are pretty hot. For example, two Internet companies agree to provide banner advertisements on each other's websites, and record the arrangements as revenue and marketing expense.
>
> The significant pressure to report larger revenues raises questions as to the quality of the information being provided. In the case of barter advertising, how has the value transferred or received been established? What evidence supported that amount? Was the amount recorded in the financial statements based on reliable and verifiable

valuations? Did it meet a reality check that that amount could have been realized in a cash transaction? The EITF currently is addressing the accounting for barter advertising transactions and is seeking to develop clear tests that must be met to satisfy the threshold imposed by APB 29 as to when fair value is determinable. However, a troubling aspect for the staff is how did this issue get so far? APB 29 addresses nonmonetary exchanges, and EITF 93-11 provides analogous guidance for barter credits. Yet, practice clearly is diverse (or worse – not in compliance with GAAP). What happened that the process was not used to identify and address this diversity? How do we ensure that issues are raised on a timely basis? (Footnotes omitted).

v. Reporting Revenue Gross Vs. Net: EITF No. 99-19

550. Reporting revenue gross as a principal versus net as an agent is governed by EITF Issue No. 99-19, which became effective for financial statements for fiscal periods beginning after December 15, 1999.

551. EITF 99-19 was issued to resolve any issue about whether a company should report revenue based on (a) the gross amount billed to a customer because it has earned revenue from the sale of the goods or services or (b) the net amount retained (that is, the amount billed to a customer less the amount paid out, i.e., to a supplier who has earned a commission or fee. As the FASB notes in EITF 99-19, "How companies report revenue for the goods and services they offer has become an increasingly important issue because some investors may value certain companies on a multiple of revenues rather than a multiple of gross profit or earnings."

4. PWC's Expertise and Industry Knowledge

552. PWC was, and is, well versed in all aspects of accounting and auditing requirements applicable to publicly owned companies like Homestore. PWC promoted itself as the "world's largest professional services organization," able to coordinate and draw on the knowledge and skills of more than 150,000 people in 150 countries, in order to address accounting and auditing challenges for any specific client.

553. PWC also specifically touted its unique auditing skills for Internet-related companies, including its ability to solve complex business problems and

measurably enhance an Internet business' ability to build value, manage risk and improve performance. Indeed, PWC promoted itself as an expert – even among the "Big 5" accounting firms – in accounting and auditing standards applicable to telecommunications and Internet companies, including a keen knowledge about the proper implementation of the relevant auditing standards discussed above.

554. PWC's partners and staff received training in all aspects of the relevant rules, received regular updates at the local offices, and in many cases, were instrumental in drafting the actual accounting and auditing standards that were applicable to such audits. In this regard, PWC maintained a strong presence on many important standards setting committees, and its partners were respected, knowledgeable professionals in the fields of accounting and auditing. Indeed, during the Class Period, PWC had <u>extensive</u> representation on the major committees setting the same accounting standards, auditing standards, SEC Regulations and professional ethics rules applicable to Homestore. PWC's experts included the following:

- <u>Robert H. Herz</u>: PWC partner until 2002; current Chairman of FASB; PWC's North American Theater Leader of Professional, Technical, Risk & Quality and a member of the firm's Global and U.S. Boards.
- <u>David B. Kaplan</u>: PWC partner; member of AICPA Accounting Standards Executive Committee that developed the Statement of Position 97-2 Software Revenue Recognition, published October 27, 1997; current member of FASB's Emerging Issues Task Force.
- <u>James S. Gerson</u>: PWC partner; Vice Chair of the AICPA Auditing Standards Board during 1998 and 1999 and Chair in 2000; Chair of the Audit Issues Task Force and Member of the International Strategy Committee and the SAS No. 71 Task Force. Mr. Gerson received a SEC letter dated October 13, 2000 entitled, "2000 Audit Risk Alert to the American Institute of Certified Public Accountants" which covered, among

other issues, Revenue Recognition, Effective Auditing and Audit Documentation.

- Jeffrey L. Close: PWC partner; member of the AICPA Fraud Task Force, appointed in 2000.
- Lawrence N. Dodyk: PWC partner; member of the AICPA Auditing Standards Executive Committee, appointed in 2000, the AcSEC Task Force to Clarify the Scope of the Investment Companies Guide, appointed in 2001, and the Business Valuation Standards Task Force, appointed in 1999.
- Philip Ashton: PWC partner; member of the AICPA Fraud Task Force, appointed in 1999, and the Risk Assessments Task Force, appointed in 2001; Chair of the International Methodologies Joint Working Group in 2000; member the International Auditing Practices Committee in 2001.
- Jay P. Hartig: PWC partner; Chair of AICPA SEC Regulations Committee, appointed in 1999.
- John W. Gribble: PWC partner; member of AICPA Joint Quality Control Standards Task Force, appointed in 2001; member of the Peer Review Committee (SECPS), appointed in 2000.
- Raymond J. Bromark: PWC partner; member of AICPA SEC Practice Section Executive Committee, appointed in 2001.
- Kenneth R. Stoll: PWC partner; member of AICPA Accounting Standards Division, Audit Task Force, appointed in 1999.
- John P. Brolly: PWC partner; member of AICPA Technical Audit Advisors Task Force, appointed in 1999.
- Richard Alan Muir: PWC partner; Chair of AICPA SEC Auditing Practice Task Force, appointed in 2000.
- William J. Borruso: PWC partner; member of AICPA Independence-Behavioral Standards Subcommittee, and Chair of Subcommittee from November 2000 through January 2002.

- Kenneth Edward Dakdduk: PWC partner; Chair of AICPA Conceptual Framework Task Force and Modernization Task Force; a member of Client Affiliate Task Force, Financial Services Task Force, Joint Task Force to Develop Best Practice Guidance on Significant Clients, and Professional Ethics Executive Committee.
- H. John Dirks: PWC partner; contributing author of Software Industry Accounting, 1997 Cumulative Supplement.
- James R. Shanahan: PWC partner until 2002; contributing author of Software Industry Accounting, 1997 Cumulative Supplement.

555. Robert Herz, in particular, was internally designated by PWC as the "final voice" on questions of whether auditors signed off on contentious accounting treatments sought by customers. Herz was well suited for that role, having served as PWC's North American Leader of Professional, Technical, Risk and Quality, the senior partner responsible for accounting standards in North America, as well as on PWC's global and United States boards. In promotional material, PWC also touted Herz' unique knowledge on emerging accounting standards, based on his prominent positions on the FASB's Emerging Issues and Financial Instruments Task Forces, the Financial Accounting Standards Committee of the American Accounting Association, and the chair of AICPA's SEC Regulations Committee. Herz also served a member of the International Accounting Standards Board ("IASB"). In 2002, Herz was named the chairman of FASB.

556. PWC promoted its internal corporate structure, including the creation of a separate "Software & Internet" Sector and "Global Information & Communications Practice," to provide professional services to Internet-related communications industries across the globe, including tax advice, financial advice, and auditing services. On its website, PWC touted its auditing abilities for

wireless and wireline service providers, access providers, and Internet service providers:

> "Drawing on our accumulated experience, we anticipated and met the challenges of global regulatory change, and have helped our clients deal with the impact of industry convergence and e-business . . . We have dedicated industry experts, extensive alliance partnerships, proven methodologies and Advanced Software Engineering Centers all geared towards understanding today's critical business issues and addressing emerging challenges to leverage tomorrow's vast opportunities."

557. In marketing its services, PWC tried to capitalize on the personal experience and expertise of its national and local partners, publishing numerous guides and reports for clients, sponsoring seminars, and for promoting itself to existing and potential clients as the foremost expert in emerging accounting issues, particularly those covering revenue recognition, barter transactions, and related party accounting for Internet companies like Homestore.

558. For example, on November 23 and 24, 1999, PWC co-hosted a "high-lever" conference in London, England, with the International Accounting Standards Committee ("IASC"), to debate emerging SEC, European and international accounting issues. The conference included a "Meet the Experts" seminar, featuring a panel of Karel Van Hulle of the European Commission, Sir Bryan Carsberg, secretary general of the IASC, Paul Cherry, chairman of the IASC's Standing Interpretation Committee, James Leisenring, vice chairman of the United States Financial Accounting Standards Board ("FASB"), and a number of senior PWC partners, including Bill Decker, Mary Keegan, Wayne Carnall, John Glynee, Robert Herz, and Dave Kaplan. The conference focused on recent auditing developments at the SEC, GAAP, FASB and the EITF.

559. PWC published on its Website a guide entitled, "Understanding IAS," in order to explain the International Accounting Standards in a "user friendly" manner and give its clients the ability to download PWC's interpretation of the standards. PWC's interpretion of IAS 18, governing revenue recognition, took

special note of "exchanges or swaps of goods or services of a similar nature or value."

560. In June 2000 and again in December 2000, PWC's published a document entitled, "Financial Reporting Release," which covered Recent Issues in Corporate Financial Reporting and devoted an entire section to Revenue Recognition issues.

561. PWC also received, and distributed to its local offices, a copy of the SEC's October 13, 2000 letter entitled, "2000 Audit Risk Alert to the American Institute of Certified Public Accountants," discussing SAB 101. PWC gave this new rule lengthy coverage in its own publications. In PWC's June 2000 "Financial Reporting Release" publication, PWC stated, "Over the past several months, securities regulators and others have continued to express concern about the lack of discipline in financial reporting, particularly interim financial reporting and revenue recognition." In the article entitled, "Revenue Recognition" in that same publication, PWC notes that "several U.S. companies have revised their revenue recognition accounting policies as a result [of SAB 101]."

562. In PWC's December 2000 edition of "Financial Reporting Release," PWC presented another article on SAB 101 entitled, "Revenue Recognition and Presentation." PWC noted that it had "issued a draft Implementation Guide, Revenue Recognition- Staff Accounting Bulletin (SAB) 101 and interpretations to respond to the many questions that have arisen, and continue to arise, with respect to SAB 101. The Guide is identified as a 'draft' inasmuch as discussions continue with the SEC staff on how the SAB should be implemented in a variety of circumstances. A copy of the Guide is available for your engagement team or from our website at www.pwcglobal.com."

563. In PWC's February 15, 2001 "Deal Flash!" publication, PWC expressed its knowledge and understanding of SAB 101. In pertinent part, PWC stated:

> In December of 1999, the SEC issued Staff Accounting Bulletin 101 (SAB 101) which specifies when companies can recognize revenue. **This was in no small part in response to the SEC's concerns about quality of earnings, first voiced over two years ago**. While intended simply to summarize and clarify existing rules, many believe SAB 101 fundamentally alters the 'revenue landscape.' SAB 101 affects sales, the most basic component of transactions, often delaying when companies can record revenue in their financial statements, even if they have collected the cash.
>
> SAB 101 specifies that revenue from a sale is earned and should be recognized when: a sales arrangement exists, delivery has occurred, the price is fixed or determinable, and collection is reasonably assured.
>
> Sounds simple, but it's not. **These criteria are in many cases stricter than the practices certain industries have followed for years, and their adoption has led to some high profile earnings restatements**. Under SAB 101 form, in some respects, trumps substance, and seemingly insignificant contract provisions can defer revenue
>
> SAB 101 presents challenges to companies struggling to cope with the realities of public disclosure. Assessing the impact of SAB 101 on a target requires a thorough understanding of how the company does business...
>
> Although companies were required to implement SAB 101 last year [2000], this is not a one-time issue. The SEC will be reviewing filings in 2001 and, in the process, provide additional guidance. (Emphasis added)

PWC's main message was that SAB 101 "makes thorough diligence paramount." Thus, PWC not only knew of the diligence required by SAB 101, it felt secure enough in that knowledge to provide information to the public in the above articles and on its web site. However, as discussed below, PWC failed to exercise this diligence in its handling of the Homestore audits.

564. PWC similarly promoted its understanding of SOP 97-2. Shortly after the release of SOP 97-2 in October 1997 by the AICPA, PWC created and disseminated the first edition of "The User-Friendly Guide to Software Revenue Recognition." The Guide was promoted to help companies "understand and follow AICPA and related guidance."

565. PWC subsequently released "Software Revenue Recognition: A User-Friendly Guide to Navigating through the Latest Accounting Standards," covering amendments to SOP 97-2 contained in SOP 98-4 and SOP 98-9, AICPA interpretations of technical questions, and the impact of SEC guidance, rule making and interpretations. Reflecting what it called "the changing nature of the

technology industry," PWC made the Guide available in three-ring binders, so that its clients could easily integrate PWC's updates. The Guide featured accounting issues receiving the most SEC attention, including recognizing revenue when a company defers payment terms and "barter transactions or round tripping." PWC posed several key questions that it could help resolve for clients, including with regard to barter transactions, "are these transactions really substantive and should they be recorded at the full invoiced value?"

566. On February 15, 2002, PWC's published a document entitled, "Deal Flash!" The document, which asked the question, "Revenue is Revenue, Right?," extensively discusses the impact of SEC SAB 101.

5. <u>Relationship Between Homestore Management and PWC</u>

567. A number of the senior executives in the Finance Department at Homestore were PWC alumni, who had followed similar career paths and had previously worked on audit engagements with members of the Homestore audit engagement team during their time at PWC.

568. Amongst the senior management at Homestore who previously had been auditors for PWC were Giesecke, Shew, DeSimone, and Kalina. These former PWC auditors held critical positions at Homestore and were vested with the authority and control within the Homestore operation to structure the financial transactions which ultimately caused the massive restatements herein alleged.

569. Giesecke, Shew and DeSimone worked on audit engagements with the Homestore audit engagement partner, Withey, when they were at PWC. This included an audit engagement for Disney, wherein Giesecke, Shew and DeSimone worked under Withey who was the audit engagement partner, and together handled many of the same audit issues on revenue recognition which arose later at Homestore. Giesecke was a senior manager at PWC at the time he departed (a position just below partner) and served in that position on the Disney audit engagement team.

570. After serving as auditors for Disney, Giesecke, Shew and DeSimone left PWC and joined Disney, where they worked together until they then departed Disney and went to work for Homestore. During the course of their respective careers at Disney, Giesecke, Shew and DeSimone continued to work with the PWC audit engagement team in their capacities as executives of Disney, and had an ongoing professional and personal relationship with the PWC auditors, including Withey.

571. As of the time of Homestore's initial public offering, PWC was engaged to do audit and due diligence work in connection with the IPO, and Withey was designated as the audit engagement partner. PWC audited each year going back to 1996 for the IPO. In preparation for the IPO, Homestore attempted to bolster its management team, and in particular its Finance Department, by recruiting Giesecke for the Controller position. Giesecke had been aspiring to the CFO position at Disney, but that position was not available to him. Throughout the period of time that Giesecke and Shew worked together, starting at PWC and continuing through their tenure at Disney, Shew considered Giesecke to be a mentor. It was therefore natural for Giesecke to look to Shew to come over to Homestore, and he recruited Shew for a position in the Finance Department at Homestore in 1999. Giesecke also looked to PWC and Disney alumni DeSimone to take over the position of Director of Planning & Transactions at Homestore, which DeSimone took starting in June 1999. They were soon joined by former PWC accountant, Kalina, who became a Director of Transactions.

572. In purposefully filling the ranks of Homestore's Finance Department with PWC and Disney alumni, Giesecke insured that his staff included people who were intimately familiar with the details of auditing based on their training and experience at PWC, and extremely well versed in the type of revenue recognition issues that were deemed to be "red flags" by PWC auditors. It also assured that personal relationships existed which could assist Homestore in dealing with

difficult questions posed by PWC. PWC alumni filled the essential finance spots in the company as it pertained to carrying out the deals put together by Business Development, and in particular, Tafeen and Wolff. The positions filled by PWC alumni at Homestore as of the beginning of FYE 2000 were:

Giesecke	Chief Financial Officer
Shew	Vice President of Finance
DeSimone	Director of Planning & Transactions
Kalina	Director of Transactions

573. In light of the close connection between the Homestore executives who came from PWC and the PWC audit team, and in particular Withey, the audit team was consulted about almost every material revenue transaction, and whether those deals could pass an audit examination. In fact, PWC did tutorials with Homestore executives from the Business Development, Finance, and Legal departments to discuss and explain how Homestore could conform its revenue deals to the form that PWC would approve in the audit process.

574. The relationship between PWC and the PWC alumni who worked at Homestore in key management positions went beyond the normal auditor/client relationship, given the familiarity between the Homestore executives and the PWC auditors, and the willingness of the PWC auditors to offer advice on how to structure the very revenue transactions that led to the restatements. PWC, and its auditors, were very involved in the process of setting the direction for and evolution of, the revenue transactions undertaken by Homestore, and were consulted outside of the audit process on such transactions.

575. PWC was considered by Homestore's senior management to be very closely involved in the discussions leading up to the structuring of the subject revenue transactions and instrumental in guiding Homestore, and its management, through the accounting rules pertaining to the same. The nature of this relationship was cultivated by the fact that Homestore senior executives, such as

Giesecke and Shew, had worked under the Homestore audit engagement partner, Withey, while at PWC, and were fully aware of the approach that would be taken by PWC on the subject transactions. This led to an environment in the Homestore engagements wherein PWC knew when not to push too hard on questionable transactions. Based on the relationships between the Homestore executives who were PWC alumni, and the PWC auditors, PWC did not apply due professional skepticism nor adequately inquired into the numerous "red flags" that were evident to them, and thereby, participated with Homestore in the perpetuation of the myth that Homestore was generating legitimate revenues as opposed to "buying revenues."

6. The Wrongful Conduct of PWC

i. Summary of Wrongdoing

576. As alleged above, PWC was deeply involved in the IPO for Homestore in 1999. PWC, a self-proclaimed expert in the auditing and accounting rules related to Internet companies such as Homestore, was involved in conducting both quarterly reviews as well as annual audits for Homestore, and had an unusually close relationship with the company as a result of the fact that key executives at Homestore were PWC alumni.

577. As part of its planning for and implementation of various engagements for Homestore, PWC was required to be thoroughly familiar with the nature of Homestore's business, the manner in which senior management ran the company, the internal control environment at the company, and the existence of any unusually high audit risks at Homestore.

578. In this role, starting as early as 1999, and continuing through and including FYE 2001, PWC knew of extraordinary "red flags" at Homestore but nevertheless approved numerous questionable transactions that allowed Homestore to meet its revenue targets, and keep Wall Street happy. These "red

flags" included the following business practices and patterns which existed at Homestore where revenue targets had to be met at all costs:

- Since its inception as a public company, Homestore had engaged in "back and forth" transactions in order to generate revenue which evolved over time, with the knowledge and approval of PWC, from (1) "true barter" transactions, to (2) "buying revenue" with warrants and stock of Homestore, to finally (3) "round tripping" transactions whereby Homestore's own money was cycled back to them as revenues.
- As known to PWC, Homestore's senior management, and in particular Wolff and Tafeen, Homestore consistently set unattainable revenue targets, based on analyses of the performance of other Internet companies, as opposed to the operational realities at Homestore, thereby setting up enormous pressure on the Homestore management to be overly aggressive in its revenue recognition practices.
- As known to PWC, Homestore customarily brought in revenue deals in the last few days of the fiscal quarter, which were of low or marginal quality, in order to make their numbers. These deals were reflected on R&O schedules that were shown to PWC.
- As known to PWC, not only were revenue deals at the very end of the quarters of marginal quality and overly aggressive in their revenue recognition approach, many of these deals were with related parties of Homestore, and therefore, required a higher level of scrutiny to assure that those transactions were negotiated at arms' length and had actual economic substance.
- As known to PWC, many of the revenue transactions which purported to attribute a value for goods and services being traded between Homestore and its partners, were actually driven by the partners' desire to obtain Homestore stock, and Homestore was actually using its warrants and stock

as currency to "buy revenue" that it could not otherwise obtain by legitimate means.

- PWC had extensive discussions and disagreed with Homestore's management about the booking of certain revenues on a "gross" versus "net" basis; nonetheless, PWC continued to allow Homestore to recognize and report such transactions on the basis of gross revenues.
- PWC knew that Homestore relied upon two important partners for its revenue deals, AOL and Cendant, to whom Homestore turned on several occasions to make their revenue targets right at the end of the quarter. Yet, PWC never questioned this "going back to the well" with these partners.
- PWC knew that AOL and Cendant were related parties of Homestore, that both companies had an enormous economic interest in Homestore by virtue of their respective share ownership, and that there were substantial and obvious incentives for AOL and Cendant to keep the share price of Homestore as high as possible.
- By virtue of its quarterly review work, and annual audit, PWC knew the impact the announcement of a large revenue deal would have on the Homestore share price, and knew that hitting revenue targets was literally an obsession at Homestore.
- PWC knew that Homestore was consistently aggressive in its revenue recognition practices, and that material amounts of the revenues that came in at the end of the quarters which allowed Homestore to hit its revenue targets were based on very subjective accounting rules which PWC had actively tutored Homestore to exploit and, ultimately, abuse.
- PWC observed and knew that end of the quarter revenue deals often had material terms that would change.
- PWC knew that Homestore had very weak internal accounting controls, was dominated by the two co-founders, Wolff and Tafeen, and that

in order to continue this domination and control, Wolff and Tafeen had most of the rest of Homestore's management reporting to them.

579. Given PWC's actual knowledge of such significant "red flags" at Homestore, particularly in the context of how sensitive and risky revenue recognition issues were, and are, for Internet-based companies, there is no basis for PWC to claim that it was unaware of the fraudulent transactions herein alleged even with the active efforts of the top four executives, Wolff, Tafeen, Giesecke, and Shew, to conceal certain aspects of the 2001 "round tripping" deals.

ii. The Early Foundations for The Fraudulent Revenue Transactions

580. Given PWC's involvement in Homestore's IPO in 1999, PWC was in the unique position of observing, as well as examining, the evolution of the revenue deals done by Homestore. PWC was not only an expert in the Internet and technology sectors, it was extensively involved in the rapidly developing accounting rules related to the recognition of revenue in those sectors. The PWC engagement team was also thoroughly familiar with the types of transactions in which Homestore engaged, based on their experience with other audit clients, including Disney. Further, to the extent there were drafts of accounting rules being circulated in the accounting industry, PWC would not only be involved in developing the rules, but would further analyze and share the anticipated impact of the rules with their clients such as Homestore.

581. PWC knew that the Homestore business model was premised on strategic partnerships which would allow Homestore to corner the Internet real estate market. This included partnerships to obtain dominant market share on the Internet itself, as well as partnerships to obtain real estate listings.

582. One of the first partnerships into which Homestore entered was with the National Association of Realtors ("NAR"). Homestore had the one and only lifetime exclusive arrangement with NAR, whereby Homestore was able to offer

the multiple listing service controlled by the NAR and its members. The NAR had over 700,000 realtor members and was an extremely powerful force in the real estate industry. In addition to having an exclusive arrangement with NAR, Homestore, of course, sold its products to NAR members. Homestore also entered into partnerships with the National Association of Home Builders and Fannie Mae, as well as entering into exclusive online listing agreements, which gave Homestore the majority of online listings in the United States.

583. The second prong of Homestore's business partnerships was on the Internet provider front. In 1998, Homestore entered into exclusive distribution arrangements with Internet providers such as Excite, Lycos and AOL.

584. Thus, from the very beginning, and throughout the entire period that PWC examined the financial statements of Homestore, the company's strategic partnerships had a "back and forth" nature to them whereby Homestore was obtaining access for its products and services, while providing the same to its partners or their constituent members.

585. In 1998, the Internet was growing at a frenetic pace, and the technology sector was in the midst of the now infamous "bubble." Homestore's Wolff and Tafeen were, from the inception of the business, aggressive in their approach to gaining a dominant position for Homestore, taking advantage of the immense power of the relationship with NAR, and obsessive about meeting or beating the revenue targets of some of technologies highest fliers like Amazon.com and eBay.

586. In the beginning, the emphasis at Homestore was to become a dominant real estate Internet company which would, of course, mean the generation of revenues based on the inherent quality of the products and services provided. However, as time progressed, it was readily evident to senior management at Homestore, and to PWC, that the business strategy had to shift to generating revenues from advertising or the re-sale of advertising. This shift, was

in part, related to the need to create revenues and not necessarily consistent with the original core business of Homestore. Neither was it necessarily consistent with the best interests of the company, since the eventual buying of revenues with warrants or stock diluted the share value, and the buying of revenues with "round tripped" cash (out of which others took commissions) was detrimental to cash flow. The shift of focus to deals whereby revenues were being bought as opposed to being generated through the core business of Homestore was a known and obvious "red flag" for PWC.

iii. 1998 – The Evolution of the Revenue Deal

587. Some of the early models for a "back and forth" deal were the third and fourth quarter 1998 RE/MAX revenue deals. These deals were structured with the full knowledge and approval of PWC, who reviewed them in connection with its quarterly review work and annual audit of FYE 1998. The RE/MAX deals were two-legged transactions. In the first leg, Homestore paid RE/MAX $5 million for five years in exchange for the exclusive right to have RE/MAX listings on the Homestore site. At the same time, and in the same agreement, RE/MAX paid Homestore the exact same amount, $5 million, in return for Homestore's development and hosting of a RE/MAX website.

588. This was a reciprocal transaction which was documented in the same agreement. Both PWC and Homestore's Board were consulted about and approved this transaction. While there is no restatement of this transaction for 1998, it presented several "red flags." First, as was Homestore's practice, the $5 million in revenues from the website development and hosting leg were not netted against the $5 million paid for the exclusive listing. Second, despite the fact that the two legs were negotiated simultaneously and contained in the same agreement, Homestore (with PWC's concurrence) did not record them as linked. Third, the fair market value of the exclusive listing agreement and the website leg were highly subjective, based primarily on the representations of management about the

value of the deal. Finally, since this was essentially a transaction in which Homestore disbursed cash to obtain revenue, no revenue should have been recognized.

589. In addition to the RE/MAX transaction, Homestore also engaged in several barter transactions for placement of advertising. For example, in 1998, Defendants Homestore and AOL formed their business relationship whereby Homestore paid AOL $20 million and issued 1.5 million warrants at various strike prices and AOL agreed to have Homestore as its exclusive online realtor.

iv. <u>1999 – The Evolution of the Revenue Deal</u>

590. In the third and fourth quarters 1999, Homestore and AOL entered into additional advertising deals which contained two of the legs that would later develop into the triangular "round tripping" of 2001. This transaction, structured with the advise and approval of PWC, combined a distribution agreement whereby Homestore provided advertising to AOL, which it would then resell to third parties. AOL, for its part, took a commission on the resale and paid Homestore the remainder under the distribution agreement. Issues were raised by PWC about the amount of the commission paid to AOL, since it was much larger that the normal commission paid on such deals.

591. In addition, in August 1999, Homestore entered into a deal with Wells Fargo, which was one of the first deals whereby Homestore offered warrants to a partner as an incentive to do the deal. The Wells Fargo deal marked the beginning of a number of similar warrant and stock deals, the economic substance of which was not adequately examined by PWC.

592. The Wells Fargo deal was done at or about the same time as the Homestore IPO, and according to plaintiff's confidential sources, the deal would not have been done without the inclusion of the warrants. In this reciprocal arrangement, Homestore obtained what was described as marketing services from Wells Fargo (e.g. banner advertising at ATM's) and paid for those marketing

services with 500,000 warrants at a strike price of $20 per share. At the same time, and as part of the same negotiations, Wells Fargo purchased banner advertising on the Homestore site for two years and paid Homestore $10 million per year. Thus, the payment in the first year was the exact amount of the value of the warrants at the strike price, $10 million.

593. PWC raised several issues about the Wells Fargo transaction, which are consistent with, and similar to, the type of issues PWC was later asked to address each time Homestore entered into a similar warrant/stock deals. For example, PWC knew that the issuance of Homestore warrants was dilutive to shareholders. PWC also knew that the "marketing services" were ill defined, and to the extent the marketing services were advertising, there was also an issue about the transaction being simply an exchange of advertising, and that Wells Fargo was, in effect, insulating itself from incurring the entire cost of its purported payment to Homestore by receiving the warrants. In addition, there was a serious question raised about the value of the warrants and the method of accounting for them under APB 29, and Homestore was not pleased with the "marketing" services it received.

594. Homestore's issuance of 500,000 warrants at a strike price of $20.00 could eventually bring in $10,000,000. Homestore's stock price during the fourth quarter of 1999 averaged approximately $47.62, aggregating approximately $23,000,000 for the 500,000 shares. Therefore, at a minimum, the difference between the $10,000,000 and $23,000,000 should have been charged as a marketing expense over the time such services were to be provided. This amount closely approximates the $20,000,000 that Homestore was to receive for advertising over a two year period. According to Plaintiff's confidential sources, Homestore recorded the $20,000,000 as revenue, rather than as paid-in capital as it should have. Accounting for equity instruments issued for goods or

services is dictated by FAS No. 123, which was issued in October 1995, with compliance required for all fiscal years beginning after December 15, 1995.

595. The economic substance of the Wells Fargo deal, with the glow of the IPO as the backdrop, was that Wells Fargo wanted the warrants, and the exchange of advertising was a convenient excuse for doing the deal. These facts and the issues associated with the deal were discussed extensively with PWC and the Board of Homestore. Despite the fact that this deal did not result in a restatement of revenues for 1999, PWC's advice of how to structure the deal was instrumental in establishing the template for similar deals whereby Homestore was buying revenue and using its stock for currency to do the same. Upon the announcement of the Wells Fargo deal, the stock price for Homestore rose approximately $17 per share.

596. Homestore entered into a similar two-legged deal, involving warrants, with GMAC in Q4 of 1999. In the first leg, Homestore paid GMAC 100,000 warrants for marketing services. In the second leg, GMAC agreed to pay Homestore $20 million over two years for website development, advertising, homepages and other unspecified technology. Again, the deal was motivated more by the value of getting Homestore stock than the value of the services provided.

597. Aside from the fact that this deal looked very much like the Wells Fargo deal, PWC raised several issues before it ultimately approved the GMAC deal. For example, PWC raised with senior management and the Board the question about netting the revenues as opposed to using the gross revenue method. PWC questioned the fair market value of the goods and services provided, which issue was particularly significant since according to a senior member of management GMAC may have never provided the promised marketing services at all. PWC also called into question the option for a third year on the Homestore website development leg, an option which Tafeen tried to exercise early in exchange for a re-pricing of the warrants in favor of GMAC.

598. According to Plaintiff's confidential sources, Homestore recorded the $20,000,000 as revenue on the GMAC deal, rather than as paid-in capital as it should have. Accounting for equity instruments issued for goods or services is dictated by FAS No. 123, which was issued in October 1995, with compliance required for all fiscal years beginning after December 15, 1995.

599. Consistent with the exuberance of the market for Internet stocks, the announcement of this $20 million GMAC deal in mid-November 1999 caused the Homestore stock to go from $55 to approximately $77 per share. Despite the fact that the GMAC transaction was not restated, it raised numerous "red flags" which were indicative of the known tendency of Homestore management to aggressively book revenues. PWC was instrumental in tutoring Homestore on how to do these deals and creating the template for how future restated revenue transactions could be done.

v. <u>2000 – The Evolution of the Revenue Deal</u>

600. In early 2000, Homestore announced a deal with Budget/Ryder Trucks. The template for the warrant deals, which had been perfected by the collaborative efforts of senior management and PWC in the Wells Fargo and GMAC deals in 1999, were taken to a new level in this first quarter 2000 deal with Budget/Ryder. The deal was again structured as a swap of advertising with two legs. In the first leg of the deal, Homestore provided banner advertising to Budget/Ryder on its website ostensibly in return for the payment of $15 million at $1.5 million per year over 10 years. In the second leg, Homestore gave Budget/Ryder 1.085 million shares of its stock at a guaranteed price of $64.50 per share, or a guaranteed aggregate value of $70 million. In return, Homestore received the right to put advertising on the Budget/Ryder rental trucks. In the same month that the guaranteed stock price of $64.50 was agreed upon with Budget, Homestore stock price fell to $46 per share.

601. As with each of the other deals herein alleged, PWC was closely involved in structuring the deal and examining it for financial statement reporting purposes. Indeed, this Budget/Ryder deal gave rise to discussions amongst PWC, senior management and the Board of Homestore about a number of "red flags." The atmosphere and culture at Homestore had not changed, and in fact, with some lessening of the market exuberance for Internet stocks and some high tech companies not hitting their targets, Homestore management was even more motivated to hit its revenue targets, which continued to be set aggressively by Wolff to meet or beat his perceived peer group of companies.

602. The first serious "red flag" with the Budget/Ryder deal, as known to PWC, was the highly diluting impact on Homestore from the sale of over 1 million shares of stock, particularly at the inflated guarantee price. Significantly, for the third time in less than a year, Homestore entered into a deal using stock at terms very lucrative for its partner. The value of the stock portion, along with the reciprocal nature of the transaction, raised the serious question about Homestore's use of stock as currency to purchase revenues. Other "red flags" raised by the Budget/Ryder deal included valuation issues for the goods and services provided (i.e. how did the $70 million in shares match the value of the advertising on the trucks), and the shift away from Homestore's core business of Internet real estate company to trader of advertising to generate revenues. In addition, the Budget/Ryder deal was one of several deals commonly described as a "Peter Deal" around Homestore, which signified that Tafeen was primarily responsible for the deal and that it was one that was particularly important to hitting the quarter's revenue target. Lastly, the entire issue of booking gross revenues was again discussed and approved by PWC.

603. Neither Homestore's Form 10-K for 2000, as originally filed, nor Homestore's press release announcing the joint marketing agreement with Budget/Ryder, disclosed the price guarantee of its stock. Homestore had an

obligation to disclose the price guarantee to shareholders and potential shareholders, pursuant to FASB No. 5, which sets forth disclosure requirements for recognizing and reporting on contingencies. PWC, as Homestore's independent auditor, also had an obligation to cause the company to adequately disclose this price guarantee in the financial statements or to state in its opinion on the financial statements that the statements did not fairly present the company's financial position and results of operations in accordance with GAAP, pursuant to AU Section 431, Adequacy of Disclosure in Financial Statements.

604. Moreover, in the second quarter of 2000, Homestore and AOL entered into a revenue sharing agreement, whereby AOL acquired 3.9 million shares of Homestore stock at a guaranteed price of $68.50 per share. However, the price of Homestore stock on May 1, 2000 (the price date per agreement) was only $22.875 and, on December 29, 2000 (the last trading day of 2000), the price of Homestore's stock had dropped to $20.125 per share. Thus, by December 31, 2000, Homestore should have recorded an additional charge to earnings for the fiscal year 2000 of approximately $178,000,000.

605. Neither Homestore's Form 10-K for 2000, as originally filed, nor its press release announcing the agreement with AOL, disclosed the price guarantee of the Homestore stock. Homestore had an obligation to disclose the price guarantee to shareholders and potential shareholders, pursuant to FASB No. 5. PWC, as Homestore's independent auditor, also had an obligation to cause the company to adequately disclose this price guarantee in the financial statements or to state in its opinion on the financial statements that the statements did not fairly present the company's financial position and results of operations in accordance with GAAP, pursuant to AU Section 431.

606. Moreover, the AOL deal, as alleged above, gave AOL a huge stake in Homestore, and was orchestrated by Tafeen for Homestore and Keller at AOL. This deal was a material and large strategic alliance for Homestore which raised

many of the same issues about reciprocity and value as alleged in further detail above. PWC was fully aware of the details of the AOL deal, consulted with senior management about how it was booked and structured, and examined the transaction in the context of both its quarterly review and annual audit work.

607. Derivations of the "stock as currency" type of transaction included multiple deals entered in the first three quarters of 2000 between Homestore and its advertising partners, Dorado, CornerHardware, Revbox, Investor Plus, OnlineChoice and Smarthome.

608. In these transactions, it was Homestore which invested in its own advertising partners and, in return, was paid by the partners to perform advertising for them. Thus, the essence of the transactions was the flip side of Homestore using its stock as currency, i.e., Homestore was inducing smaller partners to pay Homestore in their own stock and cash in return for website advertising provided by Homestore. Thus, in the first leg, Homestore bought stock in the partner for cash. In the second leg, the partner paid cash back to Homestore for website banner advertising. Thus, Homestore paid out its own cash for equity of questionable value instruments and received its own cash back as revenue.

609. Homestore improperly recorded its investment in these partners as equal to the amount of cash expended, even though, according to confidential sources, such investments had little or no value. These transactions were barter transactions and should not have been recorded as revenue, since Homestore was getting its own cash back, minus a fee retained by the partners. Accounting for barter transactions is dictated by EITF No. 99-17 and the revenue recognition of gross versus net is dictated by EITF No. 99-19, both of which were effective for Homestore's fiscal year ended December 31, 2000.

610. All of these partners were typically small, thinly capitalized Internet companies, with no obvious investment value to Homestore other than the fact they were paying back portions of the cash received as advertising revenues.

According to senior management in the Finance Department, PWC and the Board of Homestore were fully aware of, and approved, the structure of the deals.

611. While Homestore's deals with its advertising partners raised obvious accounting "red flags," PWC again failed to properly examine and challenge the economic substance of the deals as yet another form of buying revenues. Such "red flags" included the questionable value of Homestore's investment in its advertising partner, the value of the advertising that Homestore provided, and the fact that the transactions were reciprocal in nature and obviously linked. Perhaps most troubling, PWC <u>not</u> <u>only</u> recklessly ignored the valuation of Homestore's investment in its partners, but also expressly permitted Homestore to value the stock received from these partners based on the price at the time the stock was received, rather than taking into account the decreasing value over time (a prominent issue confronted in a number of Internet businesses at the time, and an issue of which PWC was particularly aware). These "red flags" are even more compelling, since even a cursory inquiry would reveal that most of the stock obtained by Homestore was worthless, and the partners had no deals of this magnitude with anyone else. Each of these factors was disclosed to PWC by senior management and extensively discussed.

vi. <u>Late 2000 – PWC's Questions Become More Pointed</u>

612. According to plaintiff's confidential sources, of the discussions between Homestore management and PWC, a series of transactions in the fourth quarter of 2000 resulted in PWC calling into question the prior practice of booking revenues in reciprocal transactions on a gross basis.

613. One set of deals which were substantially similar in structure to the Dorado, et seq., advertising transactions, described above, included Homestore's partners, I Place, Classmates, PromiseMark, Privista and Akonix. These were consummate "back and forth" deals or "true barter" transactions, whereby

Homestore and its partner exchanged cash and advertising with both sides, booking the cash as revenue without netting the respective expense.

614. The elements of these transactions, including their reciprocal nature, the questionable value of the services and products provided, and the booking of the revenues at Homestore on a gross basis, had been <u>extensively</u> discussed between PWC, senior management and the Board at Homestore since at least 1999, as alleged above. During the course of the fourth quarter of 2000, and in connection with its audit work on FYE 2001, a serious debate was occurring at Homestore between PWC, senior management, and the Board's Audit Committee about whether these deals should be booked as revenue on a gross basis. This debate arose once PWC learned of both sides of the suspect deals. In at least two instances, involving partners Akonix and City Realty (proposed first quarter 2001 revenue), PWC required Homestore to net the revenues and expenses associated with the subject deals. However, at or about the same time, in connection with two fourth quarter 2000 deals with Promisemark and Privista, which had the same type of linkage as the deals where revenues were disallowed, PWC allowed the revenues to be booked on a gross basis, assisting Homestore to make its fourth quarter revenue targets.

615. PWC claimed that its heightened sense of concern about the booking of gross revenues on "back and forth" transactions was a result of a speech made by a representative of the SEC regarding the issues of gross revenues in linked transactions in the technology sector. However, PWC was well aware of the accounting rules and had extensive experience in the Internet industry long before any such speech; especially since PWC had a hand in creating and interpreting the rules. These rules were contained in its own manuals provided to audit clients in the technology sector, who were contending with revenue recognition issues.

616. According to plaintiff's confidential sources, in late 2000 and early 2001, PWC was aware of enormous pressure on Homestore management to make

their fourth quarter target or "bogie." This pressure was contemporaneous with a debate which was raging within the company and with PWC about the "back and forth" transactions. Based on its quarterly review and annual audit work for 2000, PWC also knew that as much as 50% of the total advertising revenues for fourth quarter were low quality or questionable revenues. Each of the transactions that involved warrants, stock, or "back and forth" swapping of advertising, were exhaustively reviewed by PWC.

617. In the midst of the debate about these highly suspect transactions, Homestore embarked on a transaction with Bank of America which impacted both the fourth quarter of 2000, the annual audit for FYE 2000 and the first quarter of 2001.

vii. PWC's Inconsistent Treatment of the Q4 2000 and Q1 2001 Bank of America Deal

618. In the last quarter of 2000, there was mounting pressure to make the "bogie." R&O sheets were being circulated amongst Wolff, Tafeen, Giesecke and Shew, showing that Homestore would be short of its target. Copies of two such R&O schedules from this time period are attached hereto as Exhibit E. Tafeen told the other senior executives that he had a deal with Bank of America whereby he could get $4.5 million up front, which allowed them to get closer to their "bogie" target for the fourth quarter of 2000. In order to entice participation in the deal, Tafeen offered Bank of America 600,000 unregistered shares of Homestore stock. In addition, Homestore agreed to provide website design and development, and advertising for Bank of America on the Homestore site. In return, Bank of America agreed to pay Homestore $15 million for the website design and development, including marketing for its real estate website, My Home Solutions.com, with a $4.5 million advance in the fourth quarter of 2000 (which amount was driving the deal from Homestore's perspective).

619. Bank of America was most interested in acquiring the Homestore shares. In fact, Bank of America sent Tafeen a written presentation which explained how a public announcement of a deal with Bank of America would increase the share price of Homestore, complete with projections. The document outlined what had happened to the price of other stocks when the companies had announced a Bank of America partnership.

620. The Bank of America deal was structured over two quarters, and the $4.5 million advance was made dependent on the completion of the rest of the deal. Giesecke, Shew and DeSimone sought out the advice of Withey at PWC about the structure of the deal, and specifically how to structure the deal so that Homestore could recognize the $4.5 million as revenue in Q4 2000.

621. While Defendants needed the Bank of America deal at any cost, in order to make the projected fourth quarter revenue "bogie," the nature of the Bank of America deal, its further dilution of the shares of Homestore, and the sensitivity Wall Street was beginning to develop to non-cash components of such deals, made it a difficult deal for Wolff and Giesecke to sell to the Board. The Board expressed its concerns about the amount of stock involved in the deal.

622. The level of concern elevated to the point where, Withey, PWC's audit partner, telephoned Shew during December 2000 expressing concern about Homestore's ability to recognize revenue on the Bank of America deal. Giesecke and others in the finance department also discussed this issue with the PWC auditors, including Withey, during the same time frame, including concerns about including the $4.5 million advance as revenue in the fourth quarter, and concerns about the overall deal for the first of 2001. According to Plaintiff's confidential sources, Bank of America was only agreeing to the $4.5 million advance as a favor to Homestore, and the overall deal would still have to be consummated. Homestore, with the concurrence of PWC, and despite PWC's expression of great

concern about these type of deals, booked the $4.5 million in the fourth quarter even though the broader deal was not complete.

623. In the Q1 2000, along with expressing disagreement about the revenue recognition of other deals including CityRealty, which was disallowed, and AOL which was allowed, PWC and their audit partner, Withey, told Homestore that it could not book the Bank of America revenues in the first quarter because of the reciprocal nature of the deal and inclusion of the 600,000 shares. However, PWC did not require, nor ask, Homestore to restate the fourth quarter of 2000 and eliminate the $4.5 million advance which had the exact same problems as the overall Bank of America deal.

viii. Other Revenue Recognition Controversies Flare Up in Q1 2001

624. During the first quarter of 2001, PWC was deeply involved in examining revenue recognition practices at Homestore, including the ongoing issue about gross versus net booking of linked transactions. PWC was also conducting its audit for FYE 2000, and it had to decide if it would challenge the representations made to it by Homestore's management about revenue recognition and whether it should issue a written management recommendation letter identifying material weaknesses in internal accounting controls related to Homestore's revenue recognition practices.

625. Under the advertising reseller's agreement between AOL and Homestore, AOL resold advertising to two entities named Oxygen Media and CUC. In the first instance, CUC was a Cendant subsidiary. PWC and the management of Homestore disagreed about the recognition of revenues from these two deals. This resulted in a schedule of adjusting journal entries as proposed by PWC to back out the revenue recognition on these two deals amongst others. Homestore would not accept the adjusting journal entries on the Oxygen Media and CUC deals. However, instead of insisting that the revenues be backed out,

and despite the fact that PWC had expressed their disagreement to senior management, PWC passed the adjustment as immaterial and did not choose to put qualifying language in their audit opinion for FYE 2000. These issues, as well as the schedule setting forth the areas of disagreement, were presented to and discussed with Homestore's Audit Committee.

626. At or about this same time, Richard Jester resumed work on the Homestore engagement as a manager, and was particularly vocal about the overly aggressive revenue recognition practices at Homestore. In late 2000 or early 2001, before there was any overt attempt by Wolff, Tafeen, Giesecke and Shew to hide transactions from PWC, Jester was overheard saying to PWC auditors, who were attending a firm function, that Homestore was being too aggressive in its revenue recognition practices and booking inappropriate revenues. This was repeated by one of the auditors to Kalina, a PWC alumni, and then told to Plaintiff's confidential sources.

627. It is in this context, with tremendous pressure at Homestore to make its numbers, with elevated concern by PWC about unrecognizable revenues, and with PWC continuing to allow Homestore to recognize that revenue from the first quarter the AOL deal was completed, as described in detail above. The subject of booking the AOL deal for Q1 on a gross revenue basis, irrespective of the fact that one leg of the transaction was actively hidden from PWC, provided the opportunity for PWC to stop Homestore's overly aggressive revenue recognition practices once and for all.

628. This particular issue and deal was addressed by Shew at an Audit Committee meeting, attended by Withey. As herein above alleged, the discussion about AOL in the first quarter focused on the unusually large commission being taken by AOL and the gross versus net accounting under EITF 99-19, amongst other accounting standards. Withey did not object to the booking on a gross basis, but only added that, in light of the concerns expressed, the use of the gross

proceeds of such a deal would not be allowed again. The Audit Committee did not object, but did express concern about the risk of adopting that treatment and concurred that it should not be done again. PWC's concession on this point allowed the gross revenues of a fraudulent transaction to be booked in the first quarter of 2001, permitted Homestore to meet its target for revenues, and perpetuated the falsehood that Homestore was generating legitimate revenues from operations. In doing so, PWC not only violated its professional responsibility to Homestore and became a knowing participant in the continuing fraudulent scheme at Homestore.

629. In subsequent Audit Committee meetings, as reported by Plaintiff's confidential sources at Homestore, PWC warned the Audit Committee that Homestore was dependent on large non-recurring strategic deals, and prepared a chart showing this pattern for presentation to the Audit Committee. Withey also began to question the fact that so many "impressions" under the AOL revenue sharing agreement were coming in right at the end of the quarter. PWC, through Withey, also strongly suggested that the Akonix and CityRealty revenues not be booked, and gave the rationale to senior management in the finance department that they did not need those revenues to meet their revenue targets in any case.

630. As of the first quarter of 2001, PWC, based on a long history of observing the numerous serious "red flags" stated above, and upon recognizing the pattern at Homestore of being overly aggressive in its revenue recognition practices, PWC had specific and undeniable knowledge of improper revenue recognition that PWC should have insisted be reversed. PWC had such specific and undeniable knowledge that despite any effort by Homestore management to hide particular transactions from it, and even with such concealment, PWC was aware that Homestore was booking false revenues in order to meet their revenue targets. PWC, in reckless disregard for its obligations as an auditor and contrary to its duty under SEC rules, did not take any action to stop the practices and

affirmatively participated in them in furtherance of Homestore's scheme to defraud.

ix. 2001 – The Final Permutation of the Fraud

631. Aside from the fraudulent "round tripping" transactions alleged above, there were numerous other transactions in FYE 2001 known to PWC, which were fraught with multiple revenue recognition issues. Further, even fraudulent "round tripping" transactions with the hidden leg raised serious "red flags" and provided PWC with knowledge that they were consistent with the practice of booking improper revenues.

632. For example, in the first quarter of 2000, Homestore entered into a transaction with Cendant, whereby Cendant obtained 21.4 million shares of Homestore stock. This transaction had many of the same characteristics of the warrant/stock deals which PWC had earlier criticized. The importance of the Cendant deal to Homestore is described in detail above, at Section V(J)(2). These factors were known to PWC, which recognized, that as of late 2000 and early 2001, Cendant and AOL were the two cornerstones of Homestore's ongoing viability. Both the triangular nature of the Cendant transaction as well as the "back and forth" nature of the consideration earmarked it as "red flag" for PWC.

633. RETT, which happened to be funded by Cendant with $95 million, simultaneously agreed to purchase unidentified products from Homestore for $80 million over two years. This transaction was the functional equivalent to the "round tripping" done with the hidden leg.

634. RETT was also a related party to both Cendant and Homestore, by virtue of Cendant's stake in Homestore and its representation on the Homestore Board. Thus, any transaction between Cendant and Homestore which used RETT as a conduit to provide revenues to Homestore should have been subjected to greater scrutiny by PWC. PWC and Homestore engaged in multiple discussions with each other about the purported independence of RETT. Nonetheless, PWC

found that RETT and Cendant were not related, and the Cendant transactions with Homestore through RETT, were not disclosed initially as related party transactions in the Homestore audited financial statements for FYE 2000 and 2001, in violation of FASB 57. In the restatement, it was noted that Cendant and RETT were related parties.

635. Similarly, in June 2000, Homestore announced its acquisition of Top Producer. Homestore acquired Top Producer for approximately $24.2 million in Homestore common stock and cash. As a part of the deal, the founding shareholders of Top Producer were entitled to receive up to $16.2 million over the following four years if certain performance targets were met.

636. Later, in the fourth quarter of Fiscal Year 2000, Cendant purchased $5 million of a Top Producer product called Top Presenter. This purchase was made in the last week of the quarter and was meant to help Homestore make its numbers in order to boost Homestore's common stock price for the benefit of Cendant, which stood to gain a 20% interest in Homestore upon completion of Homestore's acquisition of Move.com. According to Plaintiff's confidential sources, as a direct result of this $5 million purchase, Cendant's obligation to provide $80 million in revenue under the Move.com acquisition agreement to Homestore was reduced to $75 million.

637. Homestore immediately recorded this deal as revenue but, according to Plaintiff's confidential sources, Homestore's act of immediately recording this revenue was highly questionable because under SOP 97-2, the software required customization after the quarter was completed. SOP 97-2 would not allow recording this deal as revenue until the customization was complete. The customization required was valued at between $100,000-$200,000 and the product could not be used or shipped to Cendant until completion of the customization. Nonetheless, the deal was immediately recorded as revenue. This was openly disclosed to PWC in the first quarter of 2001.

638. Contemporaneous with Cendant's acquisition of a huge stake in Homestore, the IPIX deal was negotiated. This deal was a triangular deal, as alleged in detail above at Section V(J)(2). In essence, Cendant agreed to buy many years worth of virtual real estate tours from Homestore, for a payment of $15 million from RETT. At the same time, Homestore purchased certain preferred alliances from Cendant for $15 million, to be paid in installments of $9 and then $6 million. Shew discussed this matter with DeSimone and Kalina, and they wondered why PWC would not question the value of buying so much of this product. There was also a heavy focus by Homestore on the immediate recognition of revenue for the sale of the tours. The treatment for revenue recognition purposes, as known to PWC and as discussed with them in conjunction with their review of this transaction, was dependent on when the tours were used and if they were, in fact full service tours. However, despite the fact that these virtual tours were initially described as full service, Homestore changed the characterization of most of the product to "self-serve" tours which allowed immediate revenue recognition. This facial change in the character of the tours, and the fact that the parties to the transaction were related, imposed an obligation on PWC to sufficiently challenge the economic substance of the transaction, and not just accept it. In fact, Cendant had no intention of doing any self-service virtual tours according to Plaintiff's confidential sources. Thus, without any concealment by Homestore management, PWC was presented with undeniable facts that should have caused them to question and disallow the IPIX revenue recognition under FASB 57 and AU Section 150.

639. PWC had intimate knowledge of the AOL deals in the first quarter and second quarter of 2001, despite the fact that there were admitted efforts on the part of certain Homestore executives to conceal certain parts of these transactions from PWC. Indeed, the transactions had many of the same characteristics of transactions which PWC had already questioned and which led up to their growing

concern in late 2000 and early 2001. These transactions were essentially barter transactions and should not have been recorded as revenue, pursuant to EITF Nos. 99-17 and 99-19.

640. PWC knew quite well during this period of time that Homestore's revenue deals had become increasingly complex and were structured so that Homestore was effectively buying revenue from its partners. Throughout the evolution of the deals, as herein alleged, PWC was closely involved in and, in fact, held tutorials with Homestore management about how to structure the deals to avoid the scrutiny of the auditors.

641. Thus, irrespective of any concealment, PWC still had concerns about the first and second quarters of 2001 AOL deals which included the fact that Withey believed that the commission structure was too high. In fact, as alleged above, Withey asked why the commission was so high, accepted a superficial answer from Shew, and never inquired further.

642. Another "red flag" was the impact on the cash flows of Homestore. PWC noticed or recklessly disregarded the negative impact on the cash flow schedule in the financial statements caused large amounts of cash going out to the third party vendors, which were not being replenished sufficiently. Even though this negative impact on cash flow was buried in a category called "SAG carry-over costs" on the internal records of the company, PWC was alert to the fact that Homestore had played games with the disclosure of barter transactions in their cash flow statement contained in the 10-K. This barter transaction was buried in another line item in the cash flow statement, and PWC objected to the way it was handled, but ultimately passed on the issue.

643. There were also serious "red flags" associated with the third party vendors with whom Homestore was doing business, as well as the goods and services that they were supposedly providing. Despite the fact that the first and second quarters of 2001 third party purchases cost Homestore millions, it does not

appear that PWC challenged what Homestore was getting for the depletion of its cash reserves, and moreover, PWC either recklessly disregarded or consciously ignored the fact that most of the third party vendors in the AOL deals were very small, thinly capitalized, had not done any similar deals before, and may not be able to deliver the goods and services in the future. These are all questions that would be asked by an auditor utilizing due professional skepticism and looking for the economic reality of the transaction, rather than blindly accepting management representations. Any questions along these lines would have served to unravel the concealed leg of the deals and prevented further fraudulent recognition of revenue.

644. It is significant that one of the third party vendors in the second quarter AOL deal was PurchasePro, i.e., the same company that caused Keller to be dismissed by AOL. Keller, as reported in the media was doing reciprocal advertising deals with PurchasePro that were similar to the deals between AOL and Homestore. These included advertising barter agreements, whereby AOL, through Keller, was doing advertising swaps with PurchasePro, and thereby generating revenues in much the same manner for which PWC was criticizing Homestore. AOL solicited PurchasePro as an advertising client for Homestore. AOL formed an alliance with PurchasePro in March of 2000 right around the time the first quarter of 2001 AOL deal was being done with Homestore. AOL paid PurchasePro $9 million and they developed a joint website. AOL and PurchasePro had a revenue sharing agreement on the advertising. The transaction also involved PurchasePro warrants which AOL booked as revenues. There was a reciprocal exchange of cash from AOL to PurchasePro. All of this ultimately led to the forced resignation of the founder of PurchasePro amid accusations of improper accounting.

645. As alleged above, as a direct result of the PurchasePro accounting scandal, and the resulting SEC investigation, Keller, Tafeen's "go to" guy at AOL was put on administrative leave. PWC could have easily put together

PurchasePro's relationship with AOL, which would have certainly raised further red flags about the supposed independent vendor relationships with Homestore.

646. For the same reasons set forth above concerning the first and second quarters of 2001 AOL deals, PWC either recklessly disregarded or chose to ignore multiple "red flags" about the L90 deals in 2001. As set forth in detail above, one of Tafeen's executives, Thomas Vo, had previously worked at L90. Tafeen used this as an entree to Mark Roah. PWC was fully advised of the nature of the L-90 second quarter deal, and passively accepted management's representations about the deal. In the third quarter, PWC finally asked who L90 was and what they did. These type of questions, if asked earlier, would have revealed to PWC that L90 had directed a substantial portion of its available cash to the Homestore deal. In fact, Withey requested and received the L90 balance sheet and income statement in the third quarter. No such inquiry was made in the second quarter, despite the fact that $4 million of revenue was recognized on the L90 deal.

647. After the third quarter closed, and after PWC allowed the L90 deal in the second quarter, PWC finally asked for a confirmation from L90 of the deal. Homestore tried to get the confirmation from L90, and when Alan Merril contacted Roah at L90 for the confirmation, he asked for $50,000 to $100,000 for it.

648. As alleged above, the L90 transactions led to a downward spiral at Homestore. Despite efforts by management to conceal certain facts from PWC, the simple request for a confirmation which took no great effort nor inconvenience ultimately uncovered a fraudulent transaction. PWC recklessly and consistently disregarded serious and multiple "red flags" which, with the exercise of just a modicum of professional skepticism, and the use of standard and unintrusive audit steps, like a confirmation, would have stopped revenue recognition fraud before the actual concealment by Homestore's management started.

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x. **Restatement**

649. PWC issued an unqualified audit report, which was published in Homestore's Form 10-K and Annual Report to Shareholders for the years ended December 31, 2000 and December 31, 1999. The unqualified audit report stated:

> "Our audits of the consolidated financial statements referred to in our report dated March 16, 2001 appearing in the Annual Report to Shareholders of Homestore.com, Inc. (which report and consolidated financial statements are included in this Annual Report on Form 10-K) also included an audit of the financial statement schedule listed in Item 14(a)(2) of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements."

650. However, by restating its financial results, Homestore has admitted that its publicly-issued financial statements for each of the restated periods were not prepared in conformity with GAAP, and that Homestore materially misstated its financial condition and results of operations. Under GAAP, the restatement of previously issued financial statements is reserved for circumstances where no lesser remedy is available. Under Accounting Principles Board Opinion No. 20, *Accounting Changes*, restatements are only permitted, and are required only to correct material accounting errors or irregularities that existed at the time the financial statements were originally prepared and issued.

651. The restatement of a company's previously issued financial statements becomes necessary when it is discovered that previously issued financial statements contained errors or irregularities in accounting which caused them to be materially misstated. Such misstatements can be the result of errors or fraud, and once discovered, the company is obligated to notify all parties who may rely on the previously issued financial statements that they should no longer place reliance thereon. The restatement of a company's previously issued financial statements is, in fact, an admission that such financial statements contained material misstatements that caused them to be misleading to the readers.

652. As a part of their scheme to defraud, Defendants dramatically and materially overstated Homestore's revenues and assets for fiscal year 2000 through the third quarter of 2001, in violation of GAAP and SEC rules prohibiting "round trip" or "barter" transactions.

653. Homestore's barter transactions did not meet the requirements of EITF No. 99-17 for recognition of revenue from advertising barter transactions. Moreover, Homestore's financial statements for the year ended December 31, 2000 were not prepared in accordance with GAAP. Homestore's advertising barter transactions were related to puchases of goods and services from other entities. Moreover, Homestore's restated financial statements for the year ended December 31, 2000 failed to present sufficient information on the advertising transactions to be in compliance with EITF No. 99-17.

654. Homestore's improperly recognized revenues accounted for 52.8% of Homestore's advertising revenue and 22.8% of total revenue for fiscal year end 2000. According to former employees of Homestore, it is not possible for an audit of the financial statements performed in accordance with GAAS to fail to discover these transactions given the pervasiveness of the conduct and the fact that it often occurred right at the end of a period in order to "make the numbers."

655. Due to Homestore's improper conduct, Homestore was forced to restate its materially misleading financial statements, filed with the SEC in its Form 10-K for 2000 and the Form 10-Qs for the first, second, and third quarters of 2001. In Homestore's Form 10-K/A for the fiscal year ended December 31, 2000, filed March 12, 2002, Homestore made the following restatements and adjustments: (*in thousands*, except per share amounts).

<u>Quarter Ended March 31, 2000</u>

	As Reported	Restated	Difference
Revenues......................................	$38,599	$37,622	$977
Gross Profit..................................	$27,841	$26,904	$937
Loss from Operations.......................	$33,607	$33,607	$0
Net Loss Applicable to Common Stockholders..............	$29,212	$29,212	$0
Basic and Diluted Net Loss Per			

Share Applicable to Common Stockholders..............................	$0.39	$0.39	$0

Quarter Ended June 30, 2000

	As Reported	Restated	Difference
Revenues.....................................	$50,152	$42,244	$7,908
Gross Profit.................................	$36,719	$28,811	$7,908
Loss from Operations.......................	$30,986	$35,558	$4,572
Net Loss Applicable to Common Stockholders..............	$24,712	$29,284	$4,572
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders..............................	$0.31	$0.37	$0.06

Quarter Ended September 30, 2000

	As Reported	Restated	Difference
Revenues.....................................	$62,203	$48,835	$13,368
Gross Profit.................................	$45,878	$32,998	$12,890
Loss from Operations.......................	$32,851	$40,439	$7,588
Net Loss Applicable to Common Stockholders..............	$27,058	$33,946	$6,888
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders..............................	$0.33	$0.41	$0.08

Quarter Ended December 31, 2000

	As Reported	Restated	Difference
Revenues.....................................	$79,013	$52,581	$26,432
Gross Profit.................................	$57,290	$31,387	$25,903
Loss from Operations.......................	$33,074	$52,498	$19,424
Net Loss Applicable to Common Stockholders..............	$34,187	$53,611	$19,424
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders..............................	$0.41	$0.65	$0.24

(Homestore Form 10-K/A for 2000, pp. 59-60).

656. For the year ended December 31, 2000, Homestore reduced its reported revenue by $48.6 million and increased its net loss from $115.2 million to 146.1 million. Homestore also increased its net loss per share from $1.44 to $1.83 (Homestore Form 10-K/A for 2000, p. 4).

657. Homestore was forced to make similar restatements and adjustments to its financial statements for the first, second, and third quarters of 2001 in its Form 10-Q/As, filed March 29, 2002 (*in thousands*, except per share amounts):

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Quarter Ended March 31, 2001

	As Reported	Restated	Difference
Revenues....................................	$105,491	$61,341	$44,150
Gross Profit................................	$77,463	$36,013	$41,450
Loss from Operations......................	$58,803	$91,465	$32,662
Net Loss Applicable to Common Stockholders..............	$67,148	$99,810	$32,662
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders..............................	$0.71	$1.05	$0.34

(Homestore Form 10-1Q/A for 2001, p.7).

Quarter Ended June 30, 2001

	As Reported	Restated	Difference
Revenues....................................	$129,283	$69,067	$60,216
Gross Profit................................	$95,265	$44,349	$50,916
Loss from Operations......................	$72,491	$120,722	$48,231
Net Loss Applicable to Common Stockholders..............	$72,075	$120,868	$48,793
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders..............................	$0.67	$1.12	$0.45

(Homestore Form 10-2Q/A for 2001, p.8).

Quarter Ended September 30, 2001

	As Reported	Restated	Difference
Revenues....................................	$116,135	$76,588	$39,547
Gross Profit................................	$84,399	$54,586	$29,813
Loss from Operations......................	$86,611	$118,272	$31,661
Net Loss Applicable to Common Stockholders..............	$106,604	$138,325	$31,721
Basic and Diluted Net Loss Per Share Applicable to Common Stockholders..............................	$0.96	$1.25	$0.29

(Homestore Form 10-3Q/A for 2001, p. 9). For the first three quarters of 2001, Homestore reduced its reported revenue by over $143.9 million and increased its net loss from $245.8 million to 359 million. Homestore also increased its net loss per share from $2.34 to $3.42 (Homestore Form 10-Q/As for 2001).

xi. Violations of Accounting and Auditing Standards

658. PWC knew, or except for its deliberate disregard of the facts would have known, that i) it had not performed its audit of Homestore's financial statements for the year ended December 31, 2000 in compliance with GAAS; ii) it never should have issued an "unqualified" audit report on Homestore's financial

statements for the year ended December 31, 2000; and iii) its audit report on Homestore's financial statements for the year ended December 31, 2000 contained materially misleading financial information.

659. The auditor's standard unqualified report states that the financial statements present fairly, in all material respects, an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. This conclusion may be expressed only when the auditor has formed such an opinion on the basis of an audit performed in accordance with generally accepted auditing standards. (AU 508.07).

660. In light of the fact that PWC had special knowledge and expertise in the areas of revenue recognition, and was aware that Homestore's revenues were an area of high audit risk that required additional scrutiny, PWC's total abdication of professional skepticism in not challenging the economic substance and reality of the subject barter transactions resulted in the issuance of a clean audit opinion on financial statements that were known by PWC to be materially misstated.

661. PWC made untrue and misleading statements of material facts and omitted material facts necessary in order to make its statements regarding Homestore's financial statements not misleading. Specifically, PWC knew that Homestore's annual financial results for its fiscal year ended December 31, 2000, and Homestore's financial results for the quarters ended March 31, 2001, June 30, 2001 and September 30, 2001, were materially overstated and were not presented in conformity with GAAP. PWC's audits and quarterly reviews were not performed in accordance with GAAS or AICPA standards.

662. Throughout the course of its quarterly and annual financial reports in 2000 and 2001, the Individual Homestore Defendants had been overstating Homestore's revenues and net income by improperly reporting revenue from sales. Such revenue should not have been recognized for all the reasons herein alleged. Homestore did not establish sufficient reserves for such returns, which were

inevitable and should have been expected, and this led Homestore to overstate its financial results in violation of GAAP. The financial statements were not in conformity with SOP 97-2, which is a part of GAAP. As a result, the quarterly and annual financial results described above were each materially misleading and false when made.

663. PWC violated GAAS General Standard No. 2, which requires the auditor to maintain an independence in mental attitude in all matters relating to the audit.

664. PWC violated GAAS General Standard No. 3, which requires the auditor to exercise due professional care in the performance of the audit and preparation of the audit report.

665. PWC violated GAAS Reporting Standard No. 1, which requires the audit report to state whether the financial statements are presented in accordance with GAAP, as PWC's audit opinion falsely represented that the Homestore financial statements complied with GAAP.

666. PWC violated GAAS Field Standard No. 1, and the standards set forth in AICPA Auditing Standards ("AU") sections 310, 320, 327, and others, by failing to adequately plan its audit and properly supervise the work of assistants so as to establish and carry out procedures reasonably designed to search for and detect the existence of errors and irregularities which would have a material effect upon the financial statements.

667. PWC violated GAAS Field Standard No. 2, which requires the auditor to make a proper study of existing internal controls, including accounting, financial and managerial controls, to determine whether reliance thereon is justified, and if such controls are not reliable, to expand the nature and scope of the auditing procedures to be applied.

668. PWC violated AU section 316.16, which requires the auditor to plan and perform its examination of the financial statements with professional skepticism.

669. PWC violated AU section 722, which requires the auditor to ensure that the Audit Committee of the Board of Directors is aware of, and responds appropriately to, any irregularities that the auditor discovers as part of a review of interim financial information to be filed with a regulatory agency, such as the SEC.

M. <u>No Safe Harbor</u>

670. Defendants are not protected by the statutory safe harbor for forward-looking statements because that protection does not extend to the allegedly false statements pleaded in this complaint. First, many of the specific statements pleaded herein were not identified as "forward-looking statements" when made. Second, to the extent there were any forward-looking statements, Defendants did not provide meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements pleaded herein. Defendants are liable for those false forward-looking statements because they knew, at the time each such statement was made, and/or authorized and/or approved by an executive officer and/or director of Homestore, that those statements were false.

FIRST CLAIM FOR RELIEF
VIOLATIONS OF SECTION 10(b), 15 U.S.C. § 78j(b) AND SEC RULE 10b-5, 17 C.F.R. § 240.10b-5

671. Plaintiff hereby incorporate by reference all of the allegations set forth above, as though fully set forth hereinafter.

672. Defendants, individually and in concert, employed devices, schemes, and artifices to defraud; made untrue statements of material fact and/or omitted material facts necessary to make the statements not misleading; and engaged in

acts, practices, and a course of business which operated as a fraud and deceit upon the purchasers of Homestore's publicly traded securities in an effort to maintain artificially high market prices for its publicly traded securities in violation of Section 10(b) of the Securities Exchange Act (15 U.S.C. §78j(b)) and SEC Rule 10b-5 (17 C.F.R. §240.10b-5). Defendants, singly and in concert, are liable as primary participants, throughout the Class Period, in the wrongful and illegal conduct charges herein, or as controlling persons as alleged below.

673. Defendants, individually and in concert, directly or indirectly, by the use, means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about the business, operations, finances, and prospects of Homestore, as specifically set forth above.

674. Defendants, individually and in concert, employed devices, schemes, and artifices to defraud, while in possession of material, adverse, non-public information, and engaged in acts, practices, and a course of conduct as alleged herein in an effort to assure investors of Homestore's value and performance and continued substantial growth. In furtherance of their scheme, Defendants made or participated in the making of, or the participation in the making of, untrue statements of material facts. Moreover, Defendants made misleading statements when they omitted material facts necessary in order to make their statements regarding Homestore and its business operations and finances truthful. Defendants engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of Homestore publicly traded securities during the relevant time period. This was contrary to Defendants' duty of full disclosure based on their participation in making affirmative statements and reports to the investing public. Defendants had a duty to promptly disseminate truthful, material information to investors (SEC Regulation S-X, 17 C.F.R. §§210.01, et seq. and Regulation S-K 17 C.F.R. §§229.10, et seq.).

675. The liability of Defendants, individually and in concert, arise from the fact that each Defendant (i) employed devices, schemes and artifices to defraud, (ii) made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and (iii) engaged in acts, practices and a course of business that operated as a fraud or deceit upon the purchasers of Homestore common stock during the Class Period.

676. During the Class Period, Defendants, and each of them, issued public statements and reports including financial statements and press releases as described above, which were materially false and misleading, in violation of Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5.

677. Defendants, and each of them, had actual knowledge of the misrepresentations and omissions of material facts set forth above, or acted with deliberately reckless disregard for the truth, in that Defendants, and each of them, failed to ascertain and to disclose such facts, even though such facts were available to them. Defendants' material misrepresentations and omissions were done knowingly or with deliberate recklessness and for the purpose and effect of concealing the true adverse financial conditions at Homestore and artificially inflating the market price of Homestore's securities, including common stock.

678. While in possession of knowledge, unknown to the public and investors, regarding Homestore's false financial statements and improper accounting, Wolff, Tafeen, Shew, Giesecke, Giffen and Rosenblatt engaged in insider trading transactions, wherein they took advantage of the inflation of stock prices that they created. During the Class Period, Wolff sold 693,600 shares of Homestore stock for proceeds of $33,763,389.75, Tafeen sold 489,195 shares of Homestore stock for proceeds of $18,095,160.45, Shew sold 108,704 shares of Homestore stock for proceeds of $4,590,818.00, Giesecke sold 200,000 shares of Homestore stock for $5,887,626.00, Giffen sold 209,183 shares of Homestore

stock for $8,176,779.64 and Rosenblatt sold 255,100 shares of Homestore stock for $9,738,160.50.

679. As a result of the wrongful conduct of Defendants, and each of them, the market price of Homestore common stock was artificially inflated during the Class Period. Relying upon the integrity of the market, and in ignorance of the adverse facts concerning Homestore concealed and misrepresented by Defendants, and each of them, Plaintiff and the members of the Class purchased Homestore common stock and were damaged thereby.

SECOND CLAIM FOR RELIEF

VIOLATIONS OF SECTION 20(a), 15 U.S.C. § 78t(a)

680. Plaintiff hereby incorporates by reference all of the allegations set forth above as though fully set forth hereafter.

681. The Individual Defendants, because of their positions of control and authority as Homestore directors and/or officers, were able to, and did control, the contents of the various SEC filings, press releases and analysts' reports. The Individual Defendants exercised control over Homestore within the meaning of § 20(a) of the Exchange Act. Had Plaintiff and other members of the Class and the marketplace known that material information had been omitted, and/or misstated, pursuant to s' fraudulent scheme, Plaintiff and the other members of the Class would not have purchased or otherwise acquired shares of Homestore common stock during the Class Period, or if they had acquired such shares during the Class Period, they would not have done so at the artificially inflated price which they paid.

682. Each of the Defendants had the ability, opportunity, and authority to prevent the issuance of the materially false and misleading SEC filings, press releases and analysts' reports or to cause them to be corrected. As a result, Defendants are responsible for the accuracy of the public reports and releases

detailed above as “group published” information, and Defendants are therefore responsible and liable for the representations contained therein.

683. Each of the Defendants was a culpable participant in the violations of Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5 thereunder, based on each having participated in the wrongful conduct alleged herein.

684. As a result of the wrongful conduct of Defendants, and each of them, the market price of Homestore common stock was artificially inflated during the Class Period. Relying upon the integrity of the market, and in ignorance of the adverse facts concerning Homestore, concealed and misrepresented by Defendants, and each of them, Plaintiff and the members of the Class purchased Homestore common stock and were damaged thereby.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff, individually and on behalf of the Class, prays for the following relief:

1. Certification of a Plaintiff Class pursuant to Rule 23 of the Federal Rules of Civil Procedure;
2. General and compensatory damages according to proof;
3. Special damages according to proof;
4. Reasonable attorneys' fees;
5. Cost and expenses of the proceedings;
6. Prejudgment interest at the maximum legal rate; and
7. Such other and further relief as the Court deems proper.

Dated: November ___, 2002 COTCHETT, PITRE, SIMON & McCARTHY

By: ______________________________
JOSEPH W. COTCHETT

Counsel for Lead Plaintiff CalSTRS and the Class

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JURY TRIAL DEMAND

Plaintiff, pursuant to Federal Rule of Civil Procedure 38, individually and on behalf of all others similarly situated, demands a trial by jury of all issues which are subject to adjudication by a trier of fact.

Dated: November ___, 2002 COTCHETT, PITRE, SIMON & McCARTHY

By: ______________________________
JOSEPH W. COTCHETT

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